

Inspector General

United States Department *of* Defense



The Audit Opinion of the DISA FY 2011 Working Capital Fund Financial Statements Was Not Adequately Supported

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Acronyms and Abbreviations

Acuity	Acuity Consulting, Inc.
AICPA	American Institute of Certified Public Accountants
CMR	Cash Management Report
COR	Contracting Officer's Representative
CSD	Computing Services Directorate
DISA	Defense Information Systems Agency
DPAS	Defense Property Accountability System
FAM	Financial Audit Manual
FBWT	Fund Balance with Treasury
GAGAS	Generally Accepted Government Auditing Standards
GAO/PCIE	Government Accountability Office/President's Council on Integrity and Efficiency
MD&A	Management Discussion and Analysis
MFR	Memorandum for Record
NoF	Notification of Finding
OIG	Office of Inspector General
PLD	Procurement and Logistics Directorate
PP&E	Property, Plant, & Equipment
TSEAS	Telecommunication Services Enterprise Acquisition Services
WCF	Working Capital Fund



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22350-1500

April 26, 2013

MEMORANDUM FOR DIRECTOR, DEFENSE INFORMATION SYSTEMS
AGENCY
CHIEF FINANCIAL EXECUTIVE, DEFENSE
INFORMATION SYSTEMS AGENCY
MANAGING PARTNER, ACUITY CONSULTING

SUBJECT: The Audit Opinion of the DISA FY 2011 Working Capital Fund Financial Statements Was Not Adequately Supported
(Report No. DODIG-2013-071)

We are providing this report for review and comment. Acuity's auditing procedures on the DISA FY 2011 Working Capital Fund Financial Statements were inadequate. In addition, the Director, Procurement and Logistics Directorate prohibited the COR from completing key duties required to provide oversight of Acuity's work. As a result, Acuity did not have sufficient evidence to issue an unqualified opinion on the DISA FY 2011 Working Capital Fund Financial Statements.

We considered management comments on a draft of this report when preparing the final report. DoD Directive 7650.3 requires that recommendations be resolved promptly. Comments from the Vice Director, DISA were generally responsive; however, comments on Recommendation 1.a and Recommendation 1.c were only partially responsive. The Managing Partner, Acuity also provided comments that were generally responsive; however, comments on Recommendation 2.b were nonresponsive. Therefore, we request additional comments on these recommendations by May 28, 2013.

If possible, send a .pdf file containing your comments to audfmr@dodig.mil. Copies of your comments must have the actual signature of the authorizing official for your organization. We are unable to accept the /Signed/ symbol in place of the actual signature. If you arrange to send classified comments electronically, you must send them over the SECRET Internet Protocol Router Network (SIPRNET).

We appreciate the courtesies extended to the staff. Please direct questions to me at (703) 604-8938 (DSN 664-8938).

Richard B. Vasquez
Richard B. Vasquez, CPA
Acting Assistant Inspector General
Financial Management and Reporting



Results in Brief: The Audit Opinion of the DISA FY 2011 Working Capital Fund Financial Statements Was Not Adequately Supported

What We Did

We determined the adequacy of Acuity Consulting's (Acuity) auditing procedures for the Defense Information Systems Agency (DISA) FY 2011 Working Capital Fund (WCF) Financial Statements. We also determined whether the contract oversight was sufficient.

What We Found

Acuity's auditing procedures on the DISA FY 2011 WCF Financial Statements were inadequate. Specifically, Acuity did not:

- properly test the DISA Fund Balance with Treasury (FBWT) reconciliations,
- determine whether the undistributed accounts were free of material misstatements,
- adequately assess whether the deficiencies identified by DISA in its FBWT memorandums for record would have a material impact on the financial statements and Acuity's opinion,
- perform adequate testing on Property, Plant, and Equipment, and
- state in its auditor's report that the DISA financial statement disclosures were inadequate.

This occurred because Acuity did not perform the audit in accordance with GAGAS, the FAM, and the AICPA standards. In addition, the contract oversight was not sufficient because the Director, Procurement and Logistics Directorate (PLD) prohibited the contracting officer's representative (COR) from completing key duties required to provide oversight of Acuity's work.

As a result, Acuity did not have sufficient evidence to issue an unqualified opinion on DISA's FY 2011 WCF Financial Statements. Furthermore, the DoD does not have assurance that the DISA FY 2011 WCF Financial Statements are free of material misstatements.

What We Recommend

The Director, DISA should review the actions of the Director, PLD; ensure that individuals performing contract oversight of financial statement audits are qualified DISA employees; and seek a refund from Acuity.

The Managing Partner, Acuity should withdraw their opinion and review the planned work on future audits to gather sufficient evidence to support their opinion.

Management Comments and Our Response

The Vice Director, DISA, responded for the Director, stating agreement with the recommendations to review the actions of the Director, PLD and ensure that the individuals performing contract oversight of financial statement audits are qualified DISA employees. We request additional comments from the Director, DISA on Recommendations 1a and 1c.

The Managing Partner, Acuity responded stating disagreement with the recommendation to withdraw their unqualified opinion. We request reconsideration from the Managing Partner, Acuity on Recommendation 2a. We request additional comments from the Managing Partner, Acuity on Recommendation 2b. Please see the recommendation table on the back of this page.

Recommendations Table

Management	Recommendations Requiring Comment	No Additional Comments Required
Director, DISA	1.a, 1.c	1.b
Managing Partner, Acuity	2.b	2.a

Please provide comments by May 28, 2013.

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Introduction

Objectives

The objective was to determine the adequacy of the Independent Public Accountant's auditing procedures for the Defense Information Systems Agency (DISA) FY 2011 Working Capital Fund (WCF) Financial Statements. We also determined whether the contract oversight performed was sufficient.

Post Audit Review Background

On June 13, 2006, the DoD Office of Inspector General (OIG) issued a policy memorandum instructing all Other Defense Organizations to execute contracts with independent public accounting firms for the audit of financial statements through the Inspector's General Chief Financial Officer Multiple Award Contract. The purpose of the policy was to ensure that the DoD OIG would maintain oversight of the financial statement audits of Other Defense Organizations. In addition, the memorandum states that ongoing monitoring would enable the DoD OIG to determine whether it could rely upon the Independent Public Accountants' work for the OIG to express an opinion on the Agency-Wide financial statements. On July 20, 2010, the DoD OIG issued a policy memorandum related to the DoD OIG oversight of the financial statement audits for the DoD. This memorandum established that the DoD OIG will conduct post audit reviews on a sample of the DoD entities financial statement audits for which we do not provide oversight.

DISA awarded a sole source contract to Acuity Consulting (Acuity) on September 30, 2010 to determine if the DISA FY 2011 WCF Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position, and Statement of Budgetary Resources present fairly in all material respects and conformity with the accounting principles generally accepted in the United States of America. The contract required Acuity to conduct the audit in accordance with Generally Accepted Accounting Principles and standards applicable to financial audits contained in the Generally Accepted Government Auditing Standards (GAGAS) issued by the Comptroller General of the United States. Although DISA is not an Office of Management and Budget reporting entity, in 2011, DISA chose to pursue an audit of its financial statements as a means to ensure the adequacy of its controls, processes, and to evaluate the accuracy of its financial reporting, as directed by the Under Secretary of Defense, Comptroller.

Defense Information Systems Agency Mission

DISA is a combat support agency comprised of 16,000 people, including military, civilian, and contractor partners. The DISA WCF reporting entity is comprised of two revolving funds which support the Computing Services Directorate (CSD) and the Telecommunications Services and Enterprise Acquisition Services (TSEAS) Directorate. The CSD provides computing services to DoD, and TSEAS provides communication services and contracting services to customers within DoD and across the federal government. DISA facilitates the use of real-time intelligence, surveillance, and

reconnaissance information to enable information exchange between the producer and the shooter. DISA works with its mission partners to provide technology and seamless exchange of information so that anyone who can connect to the network can provide and consume data and services anywhere on the network globally.

DISA provides command and control capabilities and enterprise infrastructure to continuously operate and assure a global net-centric enterprise in direct support to joint warfighters, national level leaders, and other mission and coalition partners across the full spectrum of operations.

Financial Statement Assertions

Financial statement assertions are management representations that are embodied in financial statement components. Most of the auditor's work in forming an opinion on financial statements consists of obtaining and evaluating sufficient appropriate evidence concerning the assertions in the financial statements. The assertions can be explicit or implicit. The FAM¹ section 235 classifies assertions into the following five broad categories:

- Existence or occurrence—recorded transactions and events occurred during the given period, are properly classified, and pertain to the entity. An entity's assets, liabilities, and net position exist at a given date.
- Completeness—all transactions and events that should have been recorded are recorded in the proper period. All assets, liabilities, and net position that should have been recorded have been recorded in the proper period and properly included in the financial statements.
- Rights and obligations—the entity holds or controls the rights to assets, and liabilities are the obligations of the entity at a given date.
- Accuracy/valuation or allocation—amounts and other data relating to recorded transactions and events have been recorded appropriately. Assets, liabilities, and net position are included in the financial statements at appropriate amounts, and any resulting valuation or allocation adjustments are properly recorded. Financial and other information is disclosed fairly and at appropriate amounts.
- Presentation and disclosure—the financial and other information in the financial statements is appropriately presented and described and disclosures are clearly expressed. All disclosures that should have been included in the financial statements have been included. Disclosed events and transactions have occurred and pertain to the entity.

¹ The Financial Audit Manual (FAM) presents a methodology to perform financial statement audits of federal entities in accordance with professional standards established by the American Institute of Certified Public Accountants (AICPA), GAGAS, Office of Management and Budget and the Federal Accounting Standards Advisory Board (FASAB).

Fund Balance with Treasury

The Fund Balance with Treasury (FBWT) account (U.S. Standard General Ledger account 1010) is an asset account unique to the U.S. government that represents unexpended spending authority. Entities record their budget spending authority in FBWT accounts with an offsetting amount to unexpended appropriations—U.S. Standard General Ledger account series 3100. Similar to cash in commercial bank accounts, FBWT amounts increase as funds are collected and decrease as amounts are paid. Most entities have several FBWT accounts funded by different types of appropriations that are included in the financial statement FBWT account.

As of September 30, 2011, the DISA WCF balance in the Defense WCF cash account was \$251.9 million. Because WCF funds do not expire, the \$251.9 million ending balance in the DISA FBWT account consisted of the following disbursement and collection amounts from the inception of the appropriations²:

- \$11.76 billion in disbursement and \$11.88 billion in collection transactions processed through the CSD WCF account, and
- \$52.44 billion in disbursement and \$52.59 billion in collection transactions processed through the TSEAS WCF account.

The accuracy of several entity financial statements, including the Balance Sheet, the Statement of Net Cost, and the Statement of Budgetary Resources are impacted by the FBWT account. Therefore, any material deficiencies in the FBWT account would have a significant impact on the reliability of the DISA financial statements.

Property, Plant, and Equipment

The DoD requires that all assets acquired by Other Defense Organizations be recognized for accountability and financial reporting purposes. Recognition requires the proper accounting treatment, such as the reporting of capitalized amounts and depreciation on the appropriate DoD Component's financial statements. General Property, Plant, and Equipment (PP&E), consists of tangible assets that meet all of the following criteria: (1) have an estimated useful life of 2 years or more; (2) are not intended for sale in the ordinary course of business; (3) are acquired or constructed with the intention of being used or available for use by the entity; and (4) have an initial acquisition cost, book value, or when applicable, an estimated fair market value that equals or exceeds the DoD capitalization threshold. The DoD capitalization threshold is \$100,000 with the exception of real-property assets. When recording the acquisition cost of the asset in the property accountability system of record and the accounting system, the asset should be

² The \$251.9 million ending balance also included \$13.27 million in original funding and a \$31.85 million adjustment to the TSEAS account.

assigned a dollar value and that dollar value should be supported by appropriate documentation.

Review of Internal Controls

DoD Instruction 5010.40, “Managers’ Internal Control Program (MICP) Procedures,” July 29, 2010, requires DoD organizations to implement a comprehensive system of internal controls that provides reasonable assurance that programs are operating as intended and to evaluate the effectiveness of the controls. We identified one internal control weakness for the delegation of contract administration responsibilities at DISA. Specifically, the Director, Procurement and Logistics Directorate prohibited the contracting officer’s representative from completing key duties required to provide oversight of Acuity’s work to assure the DoD that the work performed satisfied the Generally Accepted Government Auditing Standards. We will provide a copy of the report to the senior official in charge of internal controls at DISA.

Finding. Acuity's Auditing Procedures to Support Its Opinion on the DISA FY 2011 Working Capital Fund Financial Statements Were Not Effective

Acuity Consulting (Acuity) auditing procedures on the Defense Information Systems Agency's (DISA) FY 2011 Working Capital Fund (WCF) Financial Statements were inadequate. Specifically, Acuity did not:

- properly perform testing on the DISA FBWT reconciliations,
- determine whether the undistributed accounts were free of material misstatements,
- adequately assess whether the deficiencies identified by DISA in its FBWT memorandums for record (MFRs) would have a material impact on the financial statements and ultimately Acuity's opinion,
- perform adequate completeness testing of the TSEAS Property, Plant, and Equipment (PP&E) line item, and
- state in its auditor's report that the DISA financial statement footnote disclosures were inadequate because they did not discuss DISA's grouped asset cost activation and depreciation method.

This occurred because Acuity did not perform the audit in accordance with Generally Accepted Government Auditing Standards (GAGAS), the Financial Audit Manual (FAM), and the American Institute of Certified Public Accountant (AICPA) standards. Specifically, Acuity relied on DISA management representations without performing independent tests and validations. In addition, the contracting oversight was not sufficient because the Director, Procurement and Logistics Directorate prohibited the contracting officer's representative (COR) from completing key duties required to provide oversight of Acuity's work.

As a result, Acuity did not have sufficient evidence to issue an unqualified opinion on the DISA FY 2011 WCF Financial Statements.

Furthermore, without performing procedures that ensure compliance with GAGAS, FAM, and AICPA standards, the DoD does not have assurance that the DISA FY 2011 Financial Statements are free of material misstatements.

Acuity did not have sufficient evidence to issue an unqualified opinion on the DISA FY 2011 WCF Financial Statements.

Acuity Did Not Perform Sufficient Audit Procedures to Support Its Audit Opinion

On September 30, 2010, DISA awarded Acuity a contract to audit the DISA FY 2011 WCF Financial Statements. The contract required Acuity to conduct the audit in accordance with GAGAS, FAM, and AICPA standards. The contract also required Acuity to express an opinion as to whether DISA fairly presented its financial statements. However, Acuity did not perform key audit procedures to support the audit opinion on

the DISA FY 2011 WCF Financial Statements. Specifically, Acuity's procedures used to test the DISA FBWT account and PP&E line item were inadequate.

Acuity's Procedures for Auditing the DISA FBWT Account Were Inadequate

Acuity did not perform adequate auditing procedures on the FBWT account. Specifically, Acuity did not:

- perform adequate auditing procedures on the DISA FBWT reconciliations,
- determine whether the undistributed accounts were free of material misstatement, and
- adequately assess how the deficiencies identified by DISA in its FBWT MFRs would impact the reliability of the financial statements and ultimately Acuity's opinion.

Acuity Did Not Properly Test the DISA FBWT Reconciliations

Acuity's procedures for auditing the DISA FBWT reconciliations were inadequate. According to DoD OIG Report No. DODIG-2012-107 the reconciliation of the FBWT account is a key internal control process to identify unauthorized and improperly recorded transactions. However, DISA is included in U.S. Treasury Index 97, an aggregate account that does not identify the separate Other Defense Organizations sharing the U.S. Treasury account. As a result, DISA must reconcile its FBWT account to the Cash Management Report (CMR) created by the Defense Finance and Accounting Service (DFAS) Indianapolis, instead of reconciling directly to the U.S. Treasury. The CMR is similar to an account summary that a commercial bank reports on a customer's individual monthly bank statement. However, unlike a monthly bank statement, the CMR does not contain a list of the individual transactions charged to the account during the month. Instead, the CMR reports only the summary amounts for each appropriation. Therefore, the Other Defense Organizations must perform alternate procedures when reconciling their FBWT accounts. A proper Other Defense Organization FBWT reconciliation would require that DISA:

The reconciliation of the FBWT account is a key internal control process to identify unauthorized and improperly recorded transactions.

- retrieve the disbursement and collection transactions processed by the disbursing offices to support the summary amounts on the CMR,
- reconcile the detail disbursements and collections supporting the CMR to the detail disbursements and collections reported in the accounting systems, and
- research, and if necessary, resolve any variances between the transactions supporting the CMR and the transactions in the accounting system.

However, Acuity obtained only the detailed transactions recorded in the accounting system. Acuity then summed the transactions in the accounting system and compared

that summary amount to the summary amount supporting the CMR. FAM section 350 states that the auditor should use a combination of audit procedures to obtain sufficient, appropriate audit evidence regarding the operating effectiveness of controls. Acuity acknowledged that re-performing the FBWT reconciliations, identifying reconciling items, and obtaining explanations for the reconciling items were necessary procedures that they should have performed when testing the DISA FBWT reconciliations. However, to re-perform the FBWT reconciliations, Acuity would need to obtain both the detailed transactions supporting the CMR and the detailed transactions reported in the accounting system. Without reconciling the detailed transactions supporting the CMR to the detailed transactions in the accounting system, Acuity could not have re-performed and tested the DISA FBWT reconciliations at the detailed transaction level to ensure:

- controls over the FBWT account were effective,
- adjustments to the financial statements were supported, and
- the universe of disbursements and collections sampled by Acuity was complete.

After we brought this to the attention of Acuity senior management, Acuity later stated that it ensured the detailed transactions supporting the CMR equaled summary values reported on the CMR. Documentation provided by Acuity shows that the auditors then compared the summary amount supporting the CMR to the summary amount in the accounting system. However, a proper re-performance of the DISA FBWT reconciliations would require that Acuity reconcile the disbursements and collections supporting the CMR to the disbursements and collections reported in the accounting system at the detail transaction level. Therefore, the procedures Acuity stated it

The procedures Acuity stated it performed still would not represent adequate auditing procedures over the DISA FBWT reconciliations.

performed still would not represent adequate auditing procedures over the DISA FBWT reconciliations. A transaction level FBWT reconciliation will identify the transactions that have been disbursed or collected by the U.S. Treasury and subsequently reported on the CMR, but have not yet been reported in the accounting system. By only

performing a summary level reconciliation of the FBWT account and then only testing transactions recorded in the accounting system, the FBWT universe that Acuity sampled did not include any of the transactions that make up the \$31.9 million difference between the amount reported on the CMR and amount reported in the accounting system.

Acuity also acknowledged that it did not include the validation of the CMR in its audit documentation, which would have required them to obtain and document all of the detailed transactions supporting the summary amounts on the CMR. GAGAS, paragraph 4.19, states that audit documentation for financial audits performed in accordance with government auditing standards should contain sufficient information to enable an experienced auditor who has had no previous connection with the audit to ascertain from the audit documentation the evidence that supports the auditors' significant judgments and conclusions.

Acuity Did Not Determine Whether the Undistributed Accounts Were Free of Material Misstatements

Acuity did not determine whether the TSEAS and CSD “Undistributed Disbursements” accounts³ were free of material misstatements. Acuity determined that the balances in the TSEAS undistributed account, totaling \$15.3 million and the CSD undistributed account, totaling \$929,000, were both above the allocated materiality⁴ threshold for the FWT account. However, Acuity did not adequately follow-up on these identified deficiencies.

During the audit of the DISA FY 2011 WCF Financial Statements, Acuity issued a Notification of Finding (NoF) to DISA, which stated that DISA:

- was unable to identify, explain, or clear specific transactions remaining in the pool of transactions categorized as timing differences,
- did not consistently reconcile the undistributed disbursement account to identify and clear aged undistributed amounts, and
- did not segregate the unsupported undistributed amounts from the supported undistributed amounts on the journal entry.

Additionally, the NoF stated that DISA management’s inability to effectively monitor transactions in the undistributed disbursement account could lead to undetected accounting record errors and material misstatements to the financial statements.

However, Acuity did not perform any additional work on the identified issue.

AICPA AU Section 312, “Audit Risk and Materiality in Conducting an Audit,” states that the auditor should document the auditor’s conclusion as to whether uncorrected misstatements, individually or in aggregate, do or do not cause the financial statements to be materially misstated, and the basis for that conclusion. Additionally,

FAM section 1003 states that the auditor should consider the status of all known significant findings and recommendations, including whether any failure to correct previously identified deficiencies in internal controls is a significant deficiency or

DISA management’s inability to effectively monitor transactions in the undistributed disbursement account could lead to undetected accounting record errors and material misstatements

³ Undistributed accounts are intended to reduce accounts payable by the disbursements that have been posted to the U.S. Treasury, but not yet posted in the accounting system.

⁴ AICPA AU Section 320 requires the auditor to apply the concept of materiality appropriately in planning and performing the audit. Materiality, which is determined by the auditor based on professional judgment, is applied in evaluating the effect of identified misstatements on the audit and the effect of uncorrected misstatements, if any, on the financial statements. Misstatements are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users made on the basis of the financial statements.

material weakness. Without following up on the material unresolved differences identified in the undistributed accounts, Acuity had no assurance that material misstatements did not exist in the FBWT account when it issued an unqualified opinion on the DISA FY 2011 WCF Financial Statements.

AICPA AU Section 339, Audit Documentation, states that the auditor should document

significant findings or issues, actions taken to address them (including any additional evidence obtained), and the basis for the final conclusions reached. However, Acuity acknowledged it did not follow up on the activity in the undistributed accounts and did not ensure the deficiencies were factored into its opinion on the financial statements. Furthermore, Acuity recognized that its audit documentation did not explicitly discuss the risk, materiality, and impact on the financial statements.

Acuity acknowledged it did not follow up on the activity in the undistributed accounts and did not ensure the deficiencies were factored into its opinion.

Acuity Did Not Address Material Audit Trail Deficiencies

Acuity did not adequately assess whether the deficiencies identified by DISA in its FBWT MFRs would have a material impact on the financial statements and ultimately Acuity's opinion. DISA developed the MFRs in April 2010 to address prior year deficiencies related to CSD and TSEAS FBWT balances. DISA stated in the MFRs they purged \$7.8 billion in detailed transactions from the accounting system and performed approximately \$379 million in unsupported adjustments. Specifically, DISA stated that:

- for CSD, they imported \$5.2 billion into the Financial Accounting Management Information System in FY 2003 based on budgetary execution reports, rather than transaction detail, and prepared a \$186.9 million adjustment to “rebuild” the general ledger FBWT balance,
- for TSEAS, they purged \$2.6 billion in disbursements and collections when switching to the Financial Accounting Management Information System, and prepared two adjustments to “rebuild” the general ledger FBWT balance in the amounts of \$97.9 million and \$94 million.

DoD 7000.14-R, “Financial Management Regulation” Volume 6A, Chapter 2 requires DoD components to maintain audit trails in sufficient detail to permit tracing of transactions and balances from its sources to amounts reported in its systems. Audit trails are necessary to demonstrate the accuracy, completeness, and timeliness of a transaction. Additionally, the DoD Financial Management Regulation Volume 4, Chapter 2 states that documentation must be available to auditors and management to provide an audit trail and support accomplished reconciliations and resulting adjustments. However, DISA did not have audit trails to support over \$7.8 billion in detailed transactions and approximately \$379 million in unsupported adjustments to its accounting records. Without the detailed transactions to support these amounts, Acuity could not have fully tested the FBWT account for existence, completeness, and accuracy. Additionally, unlike appropriated funds, WCF funds do not ever expire. Therefore, these deficiencies will remain as long as the accounts exist.

DISA did not disclose any of the deficiencies reported in its MFRs in the notes to the financial statements. In addition, Acuity did not identify that the footnotes lacked the information needed for fair presentation and disclosure. FAM section 921 states that the auditor should determine whether the entity has presented the financial statements and footnote disclosures for the FBWT account in accordance with U.S. Generally Accepted Accounting Principles. Specifically, FAM section 921 states that the auditor should assess whether the entity disclosed and explained:

- material unreconciled differences in the notes to the financial statements, and
- material unreconciled differences that were written off by the entity during the fiscal year in the notes to the financial statements.

Acuity acknowledged that it should have included a paragraph in the audit opinion that alerted the reader to the problems documented in the MFRs and that it would consider the impact of the deficiencies on the overall audit opinion. Additionally, Acuity stated that the deficiencies should have been reported in the financial statement note disclosures and additional disclosures were under consideration. Finally, Acuity stated that one of the reasons it was willing to render an unqualified opinion on the financial statements with the audit trail issues was because DISA had implemented sustainable procedures and controls to accurately record, trace, and reconcile the FBWT account. However, as previously stated, Acuity did not perform adequate procedures on the FBWT reconciliations to determine if controls over the FBWT account were effective.

Acuity stated that the deficiencies should have been reported in the financial statement note disclosures and additional disclosures were under consideration.

Acuity also recognized that its audit documentation did not explicitly discuss the risk, materiality, and impact of the MFRs on the financial statements. GAGAS, paragraph 4.19, states that audit documentation for financial audits performed in accordance with government auditing standards should contain sufficient information to enable an experienced auditor who has had no previous connection with the audit to ascertain from the audit documentation the evidence that supports the auditors' significant judgments and conclusions.

Acuity's Reliance on DISA Management

Acuity relied on representations by DISA management and did not independently validate the representations made by DISA. Specifically, Acuity:

- performed only summary reconciliations of the FBWT account and did not adequately test to ensure DISA was performing regular and recurring FBWT reconciliations at the detailed level,
- accepted a response from DISA regarding the deficiencies in the undistributed accounts, but did not perform any follow up work on the account to ensure the undistributed accounts could be supported, and

- accepted the deficiencies DISA reported in the MFRs without performing adequate auditing procedures to determine if the deficiencies would have a material impact on the FBWT account.

GAGAS paragraph 4.03 requires an auditor to gain a sufficient understanding of internal controls to plan the audit and obtain sufficient appropriate audit evidence to render an opinion on the financial statements. Furthermore, FAM section 1001, “Management Representations” states that management representations are not a substitute for obtaining other audit evidence.

Auditing Procedures of the General Property, Plant, and Equipment Line Item Could be Improved

Acuity did not perform procedures to determine whether the PP&E line item in the DISA FY 2011 WCF Financial Statements was free of material misstatements. Specifically, Acuity did not:

- perform adequate completeness testing of the TSEAS PP&E line item, and
- state in its auditor’s report that the DISA financial statement footnote disclosures were inadequate because they did not discuss DISA’s grouped asset cost activation and depreciation method.

Completeness Testing of Property Plant and Equipment

Acuity did not perform adequate testing of the TSEAS Network PP&E to verify DISA compliance with the completeness assertion. Specifically, Acuity did not perform (floor to book)⁵ tests to verify the completeness of DISA’s property accountability system. The Defense Property Accountability System (DPAS) is the system of record used by DISA to record PP&E. Accounting information in DPAS is automatically interfaced with and transmitted to DoD accounting systems. FAM section 1003 suggests, in order to verify completeness, the auditor should test transactions in the accounts payable ledger against supporting property records to determine whether all items that should have been recorded were recorded. Instead, to verify completeness, Acuity acknowledged it could not rely on DPAS, so it performed alternate procedures to reduce its risk with respect to the DISA completeness assertion. However, we determined that the conclusions of those alternative procedures were not adequately supported.

Acuity did not perform (floor to book) tests to verify the completeness of DISA’s property accountability system.

⁵ The floor to book test is a method of verifying completeness of the accounting and property records through physical matching of an asset to its corresponding entry in the property system of record.

For example, Acuity provided its asset valuation testing as an alternative procedure. The testing required the auditor to determine whether the acquisition cost of the asset was supported and verified by reviewing the asset funding and acquisition documents. Acuity selected 6 high-dollar value assets valued at \$37.7 million out of 31 TSEAS assets valued at \$49.3 million in the PP&E 1790 and 1791 general ledger account balances. Of the six assets tested, the auditor found no discrepancies with the samples, but provided no supporting documentation to show how the auditor reached its conclusions. The FAM section 290 states that the auditor should prepare audit documentation in sufficient detail to provide a clear understanding of the work performed, the audit evidence obtained and its source and the conclusions reached. Additionally, GAGAS, paragraph 4.19, states audit documentation for financial audits performed in accordance with government auditing standards should contain sufficient information to enable an experienced auditor who has had no previous connection with the audit to ascertain from the audit documentation the evidence that supports the auditors' significant judgments and conclusions. In its workpapers, Acuity auditors noted that DISA tried repeatedly to obtain 1080 bills from the Business Transformation Agency, but were unsuccessful.

1080 bills are a standard form which constitutes an official request to pay for services delivered that present only summary data on charges to the agency. Since Acuity did not include sufficient documentation to support the results of its analysis, it did not support its use of the alternative procedures for completeness testing.

Therefore, the alternate procedures were inadequate to support its opinion on the completeness assertion as it relates to TSEAS PP&E.

Since Acuity did not include sufficient documentation to support the results of its analysis, it did not support its use of the alternative procedures for completeness testing.

Acuity Did Not State that the DISA Financial Statement Footnote Disclosures Were Inadequate in Its Auditor's Report

Acuity did not state in its auditor's report that the DISA financial statement footnote disclosures were inadequate because it did not discuss DISA's:

- Grouped Asset Cost Method, and
- Grouped Asset Activation and Depreciation Method.

Specifically, GAGAS chapter 5.03(c) states that when the auditor determines that informative disclosures are not reasonably adequate, the auditor must state so in the auditor's report. The DISA grouped asset methods deviated from the standards authorized under the DoD FMR. These deviations were required to be disclosed in the notes to the

financial statements or the management discussion and analysis (MD&A)⁶ section of the financial statements. Acuity was aware of the methods, and aware that DISA did not include the disclosures in the financial statements or the MD&A, but made no mention of the inadequate disclosures in its auditor's report.

DISA Did Not Disclose Grouped Asset Cost Method

During the review of FY 2011 beginning balances, Acuity issued a NOF discussing the DISA grouped asset cost method. Acuity stated that the NOF was caused from DISA using a grouped asset costs approach rather than the individual cost approach to identify and value assets. The DoD FMR volume 4, chapter 6 states entries to record PP&E must include sufficient information including physical quantity, location, and unit cost of the PP&E to enable periodic independent verification of the accuracy of the property

Acuity determined the effect of the grouped asset cost method increased the likelihood that a material misstatement would not be prevented or detected.

accountability records. Acuity stated that DISA records grouped assets with descriptions such as "Additional Costs" or "Systems" making it difficult to identify, observe, or verify the individual physical asset. Acuity determined that the effect of the grouped asset cost method increased the likelihood that a material misstatement would not

be prevented or detected. DISA provided a response to the NOF that acknowledged the challenges with the method and stated they designed a new business processes to support a more sustainable approach while making the process more effective for review. However, DISA did not state the problem or the action taken in the MD&A section of the report or in the notes to the financial statements.

DISA Did Not Disclose Grouped Asset Activation and Depreciation Method in its Financial Statements

The DISA grouped asset activation and depreciation method deviated from the standards in the DoD FMR. DISA based the grouped asset activation and depreciation methodology primarily from the standards in the Statement of Federal Financial Accounting Standards No. 6 and more specifically from the DoD FMR volume 4, chapter 6. Statement of Federal Financial Accounting Standards No. 6 states that various methods can be used to compute periodic depreciation expense as long as the method is systematic, rational and best reflects the use of PP&E. This standard also states that a composite or group depreciation methodology is permissible where cost of PP&E is depreciated using the same rate. More specifically, the DoD FMR, volume 4, chapter 6 states that the recorded cost of PP&E assets shall be the

⁶ Each federal financial report includes an MD&A section that addresses the reporting entity's program and financial performance measures, financial statements, systems and controls, compliance with laws and regulations, and actions taken or planned to address problems.

purchase contract cost plus ancillary costs.⁷ The DISA recorded costs of assets are actually component individual assets grouped together that may have been received over the course of a year or more.

The DoD FMR states that to begin depreciating assets, assuming the assets have the same recovery period; the event that triggers the calculation of depreciation is the date of receipt or the date installed and placed in service. The DISA method deviates from the DoD FMR policy because the DISA grouped assets are composed of assets having different recovery periods. For example, the Defense Information System Network is composed of computer equipment and network cables. The DoD FMR classifies computers and peripherals into a 5-year recovery period and fiber optic cable into a 20-year recovery period. Consequently, the DISA method of grouping assets with long and short recovery periods together increases the likelihood that useable equipment would be replaced earlier than necessary. Additionally, because certain components of a network may be received over the course of a year or more without being activated, the assets waiting to be grouped together and placed in service could potentially be fully depreciated by the time the network is actually activated.

DISA did not disclose any of the issues with the grouped asset cost activation and depreciation method in its financial statements.

Lastly, the DoD FMR specifies two methods for depreciation commencement—the Month Available for Service Method or the Mid-Year Convention Method. However, DISA starts asset depreciation in September of the year the grouped asset is activated. This method deviates from the standards set forth for depreciation commencement in the DoD FMR. However, DISA did not disclose any of the issues with the grouped asset cost activation and depreciation method in its financial statements.

Acuity's Audit Report Did Not State that the DISA Informative Disclosures Were Inadequate

Acuity did not comply with GAGAS because it did not state in the auditor's report that the DISA informative disclosures were inadequate. The DISA grouped asset cost method and the activation and depreciation method are not in accordance with accounting policy for PP&E in the DoD FMR. Statements on Auditing Standards No. 1, section 420, Consistency of Application of Generally Accepted Accounting Principles, states that changes in accounting standards that have a material effect on the financial statements may require disclosure in a note to the financial statements. Additionally the Office of Management and Budget A-136, Financial Reporting Requirements (Revised September 29, 2010), states that management should discuss important

⁷ Examples of ancillary costs include the following: engineering, architectural, and other outside services for designs, plans, specifications, and surveys.

problems that need to be addressed and actions that have been planned or taken to address those problems in the MD&A section of the statement. However, DISA did not provide informative disclosure of the grouped asset methodologies in either the notes or the MD&A section of the financial statements. Additionally, GAGAS chapter 5.03(c) states that when the auditor determines that the financial statement footnote disclosures are not reasonably adequate; the auditor must state so in the auditor's report.

In FY 2012, Acuity expressed concerns about the depreciation methodology to DISA. DISA sought an opinion on the matter from the Federal Accounting Standards Advisory Board through the Office of the Under Secretary of Defense (Comptroller). As of the date of our post-audit review, the matter was unresolved.

The Contracting Officer's Representative Was Unable to Complete Key Duties to Provide Oversight

The COR was prohibited from completing key duties required to provide oversight of Acuity's work to assure the DoD that the work performed satisfied GAGAS. The COR used the FAM section 650 as guidance to conduct contract oversight of Acuity and ensure its compliance with GAGAS. The FAM section 650, "Using the Work of Others" states that the auditor should develop an audit strategy and audit plan for reviewing and testing the work done. The FAM section 650 also states that the auditor will assist the contracting officer to ensure contractor compliance with the terms and conditions of the contract.

Although the COR did not review all required deliverables obtained from Acuity throughout the audit, some key documents were reviewed and concerns were identified with Acuity's work. For example, the COR provided comments on documents received in the planning phase, including the Plan of Action & Milestones. In addition, the COR expressed concerns that Acuity failed to provide a detailed audit plan. FAM section 210, "Overview of the Planning Phase" states that the auditor must adequately plan the audit work and the auditor should develop effective and efficient ways to obtain the sufficient appropriate evidence necessary to report on the federal entity's financial statements. The COR stated that Acuity did not provide a complete audit plan until February 2011, 4 months after the beginning of the audit.

Although the COR did not review all required deliverables obtained from Acuity throughout the audit, some key documents were reviewed and concerns were identified with Acuity's work.

When the COR was asked why they did not execute the duties as outlined in the performance work statement, the COR stated that the Director, Procurement and Logistics Directorate (PLD) did not allow them to fully perform their duties. For example, the Director, PLD, who was the contracting officer's supervisor, directed the COR:

- not to have any discussions with Acuity regarding the criteria that Acuity was contractually obligated to follow,

- not to have the COR/Acuity In-Process Review unless Acuity requested the meeting,
- not to engage Acuity in any meetings,
- to continue to pick up workpapers from Acuity on a biweekly basis, and
- to address any issues to the Director, PLD, who would then decide if the issues should be addressed with Acuity.

By placing these restrictions on the COR, the Director, PLD prevented the COR from completing essential steps that could have provided indications that Acuity was not performing the audit in accordance with audit standards and was not in compliance with the contract. The Director, PLD is not a certified public accountant, nor an experienced auditor. In addition, the Director, PLD does not hold a contracting warrant.⁸ Therefore, the Director, PLD was not qualified to provide effective oversight of a financial statement audit or determine what issues should be addressed by Acuity. However, the Director, PLD limited the COR, a qualified individual, from doing the job they were assigned. The Director, PLD stated that Acuity felt that the COR was impeding their progress because they were spending excessive time helping the COR understand the work they were doing and why they were doing it. As the audit progressed, the COR did not solicit comments from DISA management or provide feedback to Acuity because the COR was instructed by the Director, PLD not to have any discussions with Acuity or engage Acuity in any meetings. The COR obtained copies of Acuity's workpapers on a biweekly basis, but did not review the workpapers, based on the direction provided by the Director, PLD. In addition, based on the direction received from the Director, PLD, the COR did not provide comments or feedback to Acuity's draft audit report or the management representation letter as stated in the performance work statement. Therefore, the COR accepted services performed by Acuity without performing the appropriate level of review. As a result, the COR approved payments to Acuity without ensuring they satisfied the contract requirements.

The Director, PLD limited the COR, a qualified individual, from doing the job they were assigned.

Audit Standards Require Reissuance of Auditor's Report

AU Section 390, Consideration of Omitted Procedures, states that if an auditor concludes that an omission of auditing procedures considered necessary at the time of the audit impairs his present ability to support a previously expressed opinion, he should promptly apply the omitted procedure or alternative procedures that would provide a satisfactory

⁸ A warrant is the monetary authority delegated to the contracting officer. Contracting officers may bind the Government only to the extent of the authority delegated to them. Contracting officers shall receive clear instructions in writing from the appointing authority regarding the limits of their authority. However, based on management comments received from the Vice Director, DISA, the Director, PLD, as the Head of Contracting Activity, was delegated procurement authorities, including authority to enter into and administer contracts from the Director, DISA.

basis for his opinion. Additionally, when the auditor becomes aware of facts that existed at the date of the report that would have affected the report had he been aware of them, the auditor should follow the provisions of section 561.05-09, Subsequent Discovery of Facts.

AU Section 561, Subsequent Discovery of Facts, Chapter .05 states, in part, that when the subsequently discovered information is found to be reliable, existed, and material to the financial statements at the date of the auditor's report, the auditor should take action to prevent further reliance on the report. Chapters .06 through .08 go on to state that if the effect on the subsequently discovered information can be promptly determined, the auditor should notify users of the report that the auditor's report must no longer be associated with the financial statements. Notification can be provided through the web page where the original report was published. Therefore, the auditor should withdraw the original audit opinion and issue a revised auditor's report. The reason for the revision should be disclosed in the new auditor's report.

DISA Contract Required Acuity Compliance with Generally Accepted Government Auditing Standards

The DISA audit contract required that Acuity comply with standards applicable to financial audits contained in the Government Auditing Standards issued by the Comptroller General of the United States. Because Acuity did not have sufficient evidence to issue an unqualified opinion on the FY 2011 DISA WCF Financial Statements, its work did not comply with GAGAS. The Financial Acquisition Regulation Clause 52.212-4 "Contract Terms and Conditions" states that the Government may seek an equitable price reduction or adequate consideration for nonconforming services when the contractor has not performed to contract standards.

DoD Manual 7600.07-M states that substandard work by a non-Federal auditor may warrant referral for sanctions by the appropriate licensing authorities or suspension and disbarment by the contracting authority. Furthermore, a referral would be appropriate when work has significant inadequacies that make the audit so pervasively deficient that users cannot rely on it. If the circumstances justify a referral, the audit organization shall forward the appropriate documentation and a memorandum with the reason for the proposed referral action to the Assistant Inspector General for Audit Policy & Oversight. Based on the deficiencies identified in this report, we provided a referral to the Assistant Inspector General for Audit Policy & Oversight.

Substandard work by a non-Federal auditor may warrant referral for sanctions by the appropriate licensing authorities or suspension and disbarment by the contracting authority.

Conclusion

Acuity did not have sufficient evidence to issue an unqualified opinion on the FY 2011 DISA WCF Financial Statements. Furthermore, without performing procedures that ensure compliance with GAGAS, FAM, and AICPA standards, the DoD does not have

the assurance that the DISA FY 2011 Financial Statements were free of material misstatements.

Additionally, AICPA AU Section 508, Reports on Audited Financial Statements, states that if the auditors are unable to obtain sufficient audit evidence to support management's assertions about the nature of a matter involving an uncertainty and its presentation or disclosure in the financial statements, the auditor should consider the need to express a qualified opinion or to disclaim an opinion because of a scope limitation. Accordingly, because Acuity did not have sufficient evidence to support its audit opinion, it should withdraw their opinion, and users of the financial statements should be notified.

Recommendations, Management Comments, and Our Response

1. We recommend that the Director, Defense Information Systems Agency:

- a. Review the actions of the Director, Procurement and Logistics Directorate to determine whether the director acted within the scope of her authority and take appropriate corrective action as necessary.**

Director, DISA Comments

The Vice Director, DISA, responded for the director, agreed with the recommendation. He stated they are reviewing the actions of the Director, Procurement and Logistics Directorate and have noted that, based on the FAR, the Director, Procurement and Logistics Directorate, as the head of contracting activity, was delegated procurement authorities, including authority to enter into and administer contracts from the Director, DISA. Additionally, he stated that the FAR authorizes the contracting officer to specify the duties of the COR. Adjustment of the COR's duties is within the scope of the contracting officer's authority. Therefore, corrective action on the issue of authority is not necessary.

Our Response

The comments of the Vice Director, DISA were partially responsive. Based on their review, the Vice Director, DISA stated that corrective action was not necessary. The contracting officer has a responsibility to specify the duties of the COR and has the authority to adjust those duties as needed. However, DISA's response did not fully address the actions of the Director, PLD. Although the Director, PLD was designated as the Head of Contracting Authority and has also been delegated "all procurement authorities of the Director of DISA," the Director, PLD is not qualified to provide oversight over a financial statement audit or determine what issues should be addressed by Acuity. In cases where the contracting officer does not possess the technical competency needed to ensure compliance with audit standards, FAR 1.602-2(c) states contracting officers shall request the advice of specialists in audit as appropriate. Yet, the Director, PLD did not seek the advice of the COR, who was the specialist in audit standards. Therefore, we ask that the

Director, DISA provide additional comments to the final report identifying appropriate corrective action to ensure that the Director, PLD does not impede on the contract oversight responsibilities on future financial statement audits.

- b. Ensure that the responsibilities of individuals performing contract oversight of financial statement audits are fulfilled by a qualified, General Schedule 0511 series Defense Information Systems Agency employee.**

Director, DISA Comments

The Vice Director, DISA, agreed with the recommendation, and stated they will use employees, including General Schedule 0511 employees and other qualified employees, depending on the duties that need to be performed.

Our Response

The comments of the Vice Director, DISA were responsive, and no further comments are required.

- c. Seek a refund from Acuity Consulting for the audit services not provided on the Defense Information Systems Agency FY 2011 Working Capital Fund Financial Statements contract.**

Director, DISA Comments

The Vice Director, DISA stated that they believed the IPA was fulfilling its legal contract requirements throughout the execution of the auditing service contract. DISA continues to review this matter. As part of the review, DISA will have to determine whether there is a basis to seek a refund given that performance of the contract is complete. DISA stated they will need the support of the Department if they determine there is a reason to seek a refund.

Our Response

The comments of the Vice Director, DISA were partially responsive. Although the Vice Director, DISA stated that they would continue to review this matter, DISA did not state whether they concur or nonconcur with our recommendation. Additionally, this report, which illustrates the results of our review, serves as the basis for DISA to seek a refund from Acuity. Therefore, we ask that DISA obtain advice from their General Counsel on the matter of seeking a refund and provide additional comments in response to the final report identifying concurrence or nonconcurrence and corrective action taken on the recommendation.

2. We recommend that the Managing Partner, Acuity Consulting:

- a. Withdraw the unqualified opinion on the audit of the Defense Information Systems Agency FY 2011 WCF Financial Statements.**

Managing Partner, Acuity Comments

The Managing Partner, Acuity stated they disagreed with the DoD OIG's position because they had sufficient and appropriate evidence to provide a reasonable basis for an unqualified opinion on the DISA FY 2011 WCF Financial Statements. The Managing Partner, Acuity also stated they considered the risk of material misstatement associated with each material assertion, account, or class of transactions and obtained sufficient and appropriate evidence to reduce the risk of material misstatement to an acceptable level. The Managing Partner, Acuity stated the procedures performed complied with GAGAS, FAM, and AICPA standards.

Our Response

The comments of the Managing Partner, Acuity were nonresponsive. Our review as discussed in this report clearly demonstrates that Acuity did not have sufficient evidence to issue an unqualified opinion on DISA's FY 2011 WCF Financial Statements. After review of all evidence provided by Acuity, we determined that it did not:

- properly test the DISA Fund Balance with Treasury reconciliations,
- determine whether the undistributed accounts were free of material misstatements,
- adequately assess whether the deficiencies identified by DISA in its FBWT Memoranda for Record would have a material impact on the financial statements and Acuity's opinion,
- perform adequate testing on PP&E, and
- state in its auditor's report that the DISA financial statement disclosures were inadequate.

We request the Managing Partner, Acuity reconsider their position on the recommendation regarding withdrawal of the unqualified opinion on the audit of the DISA FY 2011 Working Capital Fund Financial Statements.

- b. **Review the planned work on future audits and incorporate the appropriate audit steps into their audit plan to gather sufficient evidence to support their opinion.**

Managing Partner, Acuity Comments

The Managing Partner, Acuity stated they are mindful of the importance of each plan being designed to meet the real-world issues of an audit. Where the purpose of the audit is, for example, to verify the factual existence of objects, then it may be appropriate to verify all external sources. When, as here, the purpose is to design a risk-based approach, then it is appropriate to exercise professional judgment as to what constitutes sufficient appropriate audit evidence by considering factors such as the significance of the potential misstatement in the relevant assertion and the likelihood of its having a

material effect, individually or aggregated with other potential misstatements, on the financial statements.

Our Response

The comments of the Managing Partner, Acuity were nonresponsive. The comments did not contain concurrence or nonconcurrence, corrective actions, and an estimated completion date. Therefore, we ask that Acuity provide additional comments in response to the final report identifying concurrence or nonconcurrence with our recommendation.

Appendix A. Scope and Methodology

We conducted this post audit review from March 2012 through January 2013 in accordance with GAGAS. Those standards require that we plan and perform the post audit review to obtain sufficient appropriate evidence to provide a reasonable basis for our findings and conclusions based on our objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions.

We interviewed and obtained documentation from the contracting officer, contracting officer's representative, and the Director of the Procurement and Logistics Directorate at DISA Headquarters in Ft. Meade, MD to understand their roles and responsibilities for the oversight of the DISA FY 2011 WCF Financial Statement audit. We interviewed personnel from Acuity and obtained their working paper documentation from their audit of the DISA FY 2011 WCF Financial Statement audit.

IPA Audit Procedures: We reviewed the FBWT, PP&E, and Accounts Payable line items based on the value of the line items to the total of the balance sheet. We compared the audit procedures performed by Acuity regarding FBWT, PP&E, and Accounts Payable to the requirements in the GAGAS, FAM, and the AICPA standards. We reviewed Acuity's sampling procedures documented in the working papers for the FBWT, PP&E, and Accounts Payable line items and its analysis to determine the adequacy of its conclusions. We reviewed the performance work statement for the contract and the FY 2010 ending balance sheet accounts for FBWT, PP&E, and Accounts Payable.

Contract Oversight: We identified and reviewed guidance applicable to the COR functions and responsibilities as prescribed in the DISA Acquisition Regulation Supplement Section 1.6 and the performance work statement. We collected and reviewed the COR files, specifically, the contract, memorandums, in process review write ups, audit committee meeting minutes, and correspondence between DISA and Acuity staff to review the oversight work that was performed and documented by the COR.

Use of Computer Processed Data

We used computer processed data to perform this post audit review. Specifically, we used data developed by Acuity during its audit from DPAS and the Financial Accounting Management Information System. We also relied on Excel spreadsheets, Word documents, and Adobe portable document format files created by Acuity and DISA.

We compared data developed by Acuity to determine if it had sufficient documentation to support conclusions reached in its auditor's report. From these procedures, we concluded that the data were sufficiently reliable for our audit purposes.

Use of Technical Assistance

The Quantitative Methods Division reviewed and tested the Independent Public Accountant sampling methodology to evaluate the quality of the work and to determine whether the projections derived from the sampling methodology were accurate and

reasonable. We used subject matter experts to assist the team with the analysis of FBWT and WCF property information.

Prior Coverage

During the last 5 years, the Department of Defense Office of Inspector General (DoD OIG) has issued two reports discussing the oversight of contracted audit services. Unrestricted DoD OIG reports can be accessed at <http://www.dodig.mil/pubs>.

DoD OIG

DoD OIG Report No. D-2012-116, “External Quality Control Review of the Defense Information Systems Agency Audit Organization,” August 7, 2012

DoD OIG Report No. D-2009-6-003, “Key Strategies and Practices for Oversight of DoD Contracted Audit Services,” March 3, 2009

Appendix B. Acuity's Comments on the Finding and Our Response

Acuity's Comments on Sufficient Audit Procedures to Support Its Audit Opinion

The Managing Partner, Acuity stated they disagreed with the DoD OIG's position because they had sufficient and appropriate evidence to provide a reasonable basis for an unqualified opinion on the DISA FY 2011 WCF Financial Statements. The Managing Partner, Acuity also stated they considered the risk of material misstatement associated with each material assertion, account, or class of transactions and obtained sufficient and appropriate evidence to reduce the risk of material misstatement to an acceptable level. The Managing Partner, Acuity stated the procedures performed complied with GAGAS, FAM, and AICPA standards.

Our Response

AU Section 339 states that the auditor should prepare audit documentation that enables an experienced auditor, having no previous connection to the audit, to understand:

- the nature, timing, and extent of auditing procedures performed to comply with Statements on Auditing Standards and applicable legal and regulatory requirements,
- the results of the audit procedures performed and the audit evidence obtained,
- the conclusions reached on significant matters, and
- that the accounting records agree or reconcile with the audited financial statements or other audited information.

However, Acuity did not have sufficient evidence to issue an unqualified opinion on DISA's FY 2011 WCF Financial Statements. After review of all evidence provided by Acuity, we determined that it did not:

- properly test the DISA FBWT reconciliations,
- determine whether the undistributed accounts were free of material misstatements,
- adequately assess whether the deficiencies identified by DISA in its FBWT MFR would have a material impact on the financial statements and Acuity's opinion,
- perform adequate testing on PP&E, and
- state in its auditor's report that the DISA financial statement disclosures were inadequate.

For our responses to Acuity's comments regarding FBWT and PP&E, please see pages 25 and 30, respectively.

Acuity's Comments on Properly Testing DISA FBWT Reconciliations

The Managing Partner, Acuity stated they disagreed that their work was inadequate. The Managing Partner, Acuity stated that their audit approach controlled the risk of material misstatement to an acceptable level. The Managing Partner, Acuity also stated they performed substantive audit procedures related to the financial statement reporting process. Specifically, the Managing Partner, Acuity stated they:

- observed DISA's FBWT reconciliation processes and reviewed them,
- performed an independent reconciliation of FBWT and the CMR, including detailed substantive and internal control testing of collection and disbursement transactions,
- performed a reconciliation of CMR cash activity to the AR(M) 1307 Report and Net Outlays on the Standard Form 133,
- examined and performed an independent reconciliation of the DFAS-Indianapolis SF 133 Reconciliation to the Cash Balance at the .05 level, which was from a reliable independent source, and
- reconciled the ending Defense Working Capital Fund FBWT balance to the balance reported on the Government Wide Accounting reports, another reliable independent source (that is, U.S. Department of Treasury).

In addition, the Managing Partner, Acuity stated they prepared supplemental summary workpapers subsequent to the audit to more clearly document the work performed and tie related work together to facilitate a review by an independent reviewer. On August 30, 2012, they provided these workpapers to the DoD OIG.

Our Response

AU Section 318 states that the auditor should use a combination of audit procedures to obtain sufficient, appropriate audit evidence that controls are operating effectively. In Acuity's August 30, 2012 written response to the DoD OIG, the Managing Partner acknowledged that audit principles require them to perform the reconciliations, identify reconciling items, and obtain explanations for the reconciling items.

A proper Other Defense Organizations' FBWT reconciliation should include the following steps:

- retrieving the disbursement and collection detail processed by the disbursing offices to support the summary amounts on the CMR,
- reconciling the disbursements and collections supporting the CMR to the disbursements and collections reported in the accounting system; to have an adequate audit trail for the reconciliation of the Other Defense Organizations' FBWT accounts, it is essential to have both the transactions supporting the amounts on the CMR and the transactions supporting the amounts in the accounting system, and

- researching, and if necessary resolving, any variances between the transactions supporting the CMR and the transactions in the accounting system.

Acuity has not provided any audit documentation throughout the course of the audit to demonstrate that it had adequately performed and tested the DISA FBWT reconciliations. Rather, in its August 30, 2012 response to the DoD OIG, it reiterated the work it had done, which only included summary reconciliations and detail testing of disbursements and collections. However, as already noted in this report, summary FBWT reconciliations are not adequate to ensure controls over the FBWT account were effective and that adjustments to the financial statements were supported. AU Section 326 states that the auditor should obtain and evaluate evidential matter concerning the assertions in such financial statements when forming its opinion on the financial statements. Without properly testing the FBWT reconciliations, Acuity could not have ensured all transactions that should have been recorded were recorded. As a result, Acuity could not have validated DISA management's completion assertion.

In the August 30, 2012 response to the DoD OIG, the Managing Partner, Acuity stated that requesting and obtaining all of the transactions that comprise the CMR would be akin to asking a commercial client to require their financial institution provide all the transactions they process. However, DISA is required to reconcile its FBWT at the transaction level on a regular and recurring basis and are also required to maintain the detailed reconciliations for the auditors. Therefore, DISA should have these transactions readily available. The comment provided by the Managing Partner, Acuity on August 30, 2012 indicates the fact that DISA is either not properly performing regular and recurring FBWT reconciliations at the detail level or Acuity did not properly audit the account. While Acuity has stated that it observed, reviewed, and tested the DISA FBWT reconciliations, Acuity's workpapers did not contain any documentation supporting this assertion. Audit standards require the audit documentation to stand on its own.

AU Section 339 and GAGAS Section 4.19 state that audit documentation for financial audits should contain sufficient information to enable an experienced auditor who has had no previous connection with the audit to ascertain from the audit documentation the evidence that supports the auditors' significant judgments and conclusions. In the case of Acuity's work performed on the DISA FBWT reconciliations, the audit documentation did not comply with these standards.

Acuity's Comments on Determining Whether the Undistributed Accounts Were Free of Material Misstatement

The Managing Partner, Acuity stated they disagreed with DoD OIG's conclusion that Acuity did not adequately follow up on the identified deficiencies. The Managing Partner, Acuity stated that the report does not specifically articulate why DoD OIG believes Acuity's procedures might result in an unacceptable risk of material misstatement. Specifically, the Managing Partner, Acuity stated they:

- performed interim tests of the accounts payable undistributed accounts as part of baseline testing and throughout the year, including Q2 (CSD), Q3 (CSD and TSEAS), and Q4 (CSD and TSEAS), which identified DISA's continuous improvement in analyzing and understanding the nature of the transactions in this account and the resulting ability to reduce the volume of transactions and value of accounts payable undistributed disbursements, and
- performed audit procedures that provided sufficient and appropriate evidence to provide a reasonable basis for the conclusion regarding accounts payable undistributed disbursements.

The Managing Partner, Acuity stated they performed an audit procedure to analyze the accounts payable undistributed disbursement transaction activity in October 2011, comparing to the transactions comprising the reported balance on September 30, 2011, and determined the related transactions had cleared through the normal process. The Managing Partner, Acuity stated it appears the DoD OIG did not consider the results of the subsequently performed procedure or their conclusion that there was no risk of material misstatement.

Our Response

During the audit of the DISA FY 2011 WCF Financial Statements, Acuity determined that the balances in the CSD undistributed account, totaling \$0.93 million, and the TSEAS undistributed account, totaling \$15.3 million, were both material deficiencies. Specifically, Acuity reported that:

- DISA was unable to identify, explain, or clear specific transactions remaining in the pool of transactions categorized as timing differences,
- DISA did not consistently reconcile the undistributed disbursement account to identify and clear aged undistributed amounts, and
- DISA did not segregate the journal entry for unsupported undistributed amounts from the journal entry for the undistributed amounts that can be supported.

Acuity concluded that DISA management's inability to effectively monitor transactions in the undistributed disbursement account could lead to undetected accounting record inaccuracies and potentially material misstatements to the financial statements. Despite identifying the material deficiencies during the course of the audit, Acuity still issued an unqualified opinion on the DISA FY 2011 WCF Financial Statements. In fact, only after the DoD OIG informed Acuity that it did not perform sufficient auditing procedures on the undistributed accounts did Acuity provide any additional workpapers on the undistributed accounts that it reported as being materially deficient. However, Acuity did not provide these additional workpapers on the undistributed accounts until August 30, 2012, 10 months after the unqualified opinion was rendered. AU Section 339 states that the auditor should document significant findings or issues, actions taken to address them, and the basis for the final conclusions reached. Acuity did not comply with the aforementioned auditing standard by not following up on the deficiencies they identified in the undistributed account during the FY 2011 DISA WCF financial statement audit in a timely manner.

While the work Acuity provided to the DoD OIG on August 30, 2012 is an improvement from the procedures originally performed, DISA still could not identify \$233,900 that remained in the TSEAS undistributed account and \$117,300 that remained in the CSD undistributed accounts in October 2011. Therefore, even though Acuity states that these amounts are below the materiality thresholds for the FBWT accounts, it is possible that the amounts calculated by Acuity could include transactions with negative and positive amounts. As a result, when the amounts are netted against one another, the totals would be much smaller than if the amounts were calculated in the absolute form and subsequently summed. A transaction level reconciliation would have identified each undistributed transaction at the detail level allowing DISA to identify each transaction that was disbursed or collected, but not yet recorded in the accounting system. If Acuity had adequately performed and tested the DISA FBWT reconciliations, it could have identified the transactions supporting the accounting adjustments at the time the adjustments were performed.

Acuity's Comments on Addressing Material Audit Trail Deficiencies

The Managing Partner, Acuity stated although they fully assessed the MFR deficiencies, they determined they did not clearly document all of their conclusions. The Managing Partner, Acuity, stated that the audit report does not specifically articulate why DoD OIG believes the FBWT MFR deficiencies would impact Acuity's opinion. The Managing Partner, Acuity stated they performed a risk-based and standards-based audit approach in accordance with AICPA standards. Specifically, the Managing Partner, Acuity stated they:

- conducted a thorough review of the documentation and data provided by DISA in support of the MFRs,
- determined the risk of material misstatement was sufficiently low,
- applied appropriate procedures to test internal controls on the FBWT reconciliation process and the collection and disbursement transactions, and
- evaluated the reasonableness of the estimated beginning balances.

The Managing Partner, Acuity stated the financial statements accompanied by the auditor's report for FY 2011 could have included an explanatory paragraph of emphasis and more complete disclosures for FBWT. The Managing Partner, Acuity stated that DISA made the appropriate corrections and revisions to the note disclosures to the FY 2012 comparative financial statements. Additionally, the Managing Partner, Acuity, stated they included an explanatory paragraph in the auditor's report, which was issued November 15, 2012.

Our Response

Throughout its validation efforts in the four years leading up to the FY 2011 DISA WCF Financial Statements audit, Acuity issued several Notifications of Findings and Recommendations to DISA with respect to the FBWT account. The essence of these

Notifications of Findings and Recommendations was that the ending FBWT balance as of September 30, 2007 could not be supported because of insufficient audit evidence and insufficient audit trails. After several discussions with the Defense Finance and Accounting Service regarding the deficiencies, Acuity agreed with DISA that drafting an MFR was a feasible course of action. The Managing Partner, Acuity acknowledged in their response to the draft report that the original source documentation supporting disbursements and collections prior to FY 2007 was still no longer available. In doing so, the Managing Partner, Acuity recognized that DISA still did not have over \$7.8 billion in detailed transactions that were purged from the accounting system and also that DISA performed approximately \$379 million in unsupported adjustments that were posted to the accounting records; amounts which continue to impact the DISA FBWT account.

Without the detail transactions to support these amounts, it would have been impossible for Acuity to have fully validated the existence, completeness, and accuracy assertions of the FBWT account. AU Section 318 states that if the auditor has not obtained sufficient appropriate audit evidence as to a material financial statement assertion, the auditor should attempt to obtain further audit evidence. If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor should express a qualified opinion or a disclaimer of opinion. It is not clear to the DoD OIG how the MFR, an instrument DISA used to document the billions of dollars in material deficiencies, would fix the audit evidence and audit trail issues identified by Acuity in its Notifications of Findings and Recommendations. As a result, Acuity should have expressed a qualified opinion or a disclaimer of opinion. The Managing Partner, Acuity stated in their response that Acuity “determined the risk of material misstatement was sufficiently low to provide a reasonable basis for an unqualified opinion based on DISA FBWT (that is, collection and disbursement) internal controls in place since FY 2007.” The FBWT reconciliation is a key internal control over the FBWT account. Therefore, by not adequately testing the FBWT reconciliations, as we have found to be the case, the Managing Partner, Acuity, did not obtain sufficient appropriate evidence for an unqualified opinion.

Finally, the Managing Partner, Acuity, acknowledged that the financial statements accompanied by the auditor’s report for FY 2011 could have included an explanatory paragraph of emphasis and more complete disclosures for FBWT. However, Acuity did not believe reissuance of the FY 2011 audited financial report was warranted and instead ensured that DISA made the appropriate corrections and revisions to the note disclosures in the FY 2012 comparative financial statements. Additionally, Acuity included an explanatory paragraph in the FY 2012 audit report highlighting the issues discussed in the MFR. However, this does not negate the fact that the deficiency should have been included in the FY 2011 DISA WCF Financial Statements and in Acuity’s FY 2011 audit report, because Acuity knew of this issue well before August 30, 2012. AU Section 561.06(a) states disclosure should consist of issuing, as soon as practicable, revised financial statements and auditor’s report.

Acuity's Comments on Its Reliance on DISA Management

The Managing Partner, Acuity stated they acted in accordance with auditing standards and were unbiased with respect to DISA management's representations and exercised professional skepticism. The Managing Partner, Acuity stated they provided additional documentation to tie related work together to facilitate a review by an independent auditor. The Managing Partner, Acuity requested that the DoD OIG consider these supplemental workpapers in its present review and update the draft report to reflect consideration of these documents.

Our Response

As already noted in our responses to the Managing Partner, Acuity, the DoD OIG reviewed the supplemental audit documentation provided by Acuity and still does not believe Acuity performed adequate work to ensure:

- DISA was performing regular and recurring FBWT reconciliations,
- DISA was able to identify and explain the undistributed accounts at the time the accounting adjustments were performed, leading to possible accounting record inaccuracies and potential material misstatements, and
- DISA's MFRs pertaining to the FBWT would not affect the audit opinion rendered on the DISA FY 2011 Financial Statements.

GAGAS paragraph 4.03 requires an auditor to gain a sufficient understanding of internal controls to plan the audit, and to obtain sufficient, competent, evidential matter to render an opinion on the financial statements. By not performing adequate audit work on the three issues above, Acuity did not gain the sufficient evidence to issue an unqualified opinion on the DISA Financial Statements.

Acuity's Comments on Completeness Testing of Property, Plant, and Equipment

The Managing Partner, Acuity stated they performed risked based and standards based procedures and quoted standards from AU Section 230, "Due Professional Care" on all components of TSEAS PP&E. The Managing Partner, Acuity stated they:

- documented their inability to rely on DPAS for certain classes of TSEAS PP&E and noted that they would apply alternative procedures for testing completeness with respect to TSEAS network PP&E,
- determined appropriate alternative procedures, and
- tested the TSEAS pending assets process (including certain transactions to test controls) as well as the capital budget process.

The Managing Partner, Acuity stated their analysis as a whole and the procedures they performed with respect to completeness reduced the risk to an acceptable level.

The Managing Partner, Acuity stated they prepared supplemental summary workpapers subsequent to the audit to provide clarity with respect to their conclusions and to more

fully reference and link the work performed throughout the audit to facilitate a review by an independent reviewer. The Managing Partner, Acuity requested that the DoD OIG consider these supplemental workpapers in its present review and update the draft report to reflect consideration of these documents.

Our Response

AU Section 230.10 states while exercising due professional care, the auditor must plan and perform the audit to obtain sufficient appropriate audit evidence so that audit risk will be limited to a low level that is, in his professional judgment, appropriate for expressing an opinion. Additionally GAGAS 3.32 through 3.37 states that professional judgment includes exercising reasonable care and professional skepticism. The use of professional judgment includes consideration about whether the audit team's overall understanding is sufficient to assess the audit risk. Furthermore, within the context of audit risk, an integral part of the audit process is exercising professional judgment in determining the sufficiency and appropriateness of evidence. Based on our review, we determined that Acuity did not meet the standard of due professional care and professional judgment for reasonable assurance to reduce the completeness assertion on PP&E because its alternative procedures were inadequate. The alternative procedures were inadequate because Acuity did not obtain sufficient appropriate evidence for the pending asset reconciliation process and the asset valuation process to reduce the audit risk to a low level.

Of the three alternative procedures performed by Acuity, the DoD OIG only agrees with the inclusion of the test of budgetary controls as a reasonable method to reduce the risk assessment of the completeness assertion from the highest level. The DoD OIG concluded that the Pending Asset Reconciliation Process and asset valuation procedures that Acuity conducted should not have been included in its justification to reduce the completeness risk to an acceptable level. Therefore, the DoD OIG determined that because only one of three alternative procedures were suitable to include in its risk assessment in conjunction with its acknowledgement that during the validation it could not rely on DPAS, Acuity should have assessed the risk related to material misstatement of the completeness assertion at the high/moderate level and conducted detailed completeness testing or issued an opinion other than unqualified opinion.

Specifically:

- Budget-to-Reporting Process—Acuity considered the work performed during its test on DISA's budgetary controls in its assessment of risk with respect to the completeness assertion on TSEAS network assets. Acuity provided a summary of its control test. Acuity assessed the effectiveness of budgetary control activities as effective. Acuity matched the General Ledger Account Code 1790 to the Office of the Under Secretary of Defense budget allotment for TSEAS and provided documentation in its workpapers.

Based on our review, we determined that this is an appropriate method of ensuring and documenting that the cost in the General Ledger Account Code 1790

agrees with the appropriation and is supported by source documents. Therefore, we agree with Acuity's inclusion of its Budget-to-Reporting control testing as a suitable alternative to include in its justification to reduce the completeness risk assertion to an acceptable level.

- Pending Asset Reconciliation Process—Acuity concluded that for baseline 2010 testing, the process documented on the methodology of DISA's preparation of monthly reconciliations is reasonable to rely on for transactions in the TSEAS PP&E account.

Based on our review, we determined Acuity's workpapers do not document its analysis of DISA's reconciliation process and therefore do not meet the standards in AU Section 230 or GAGAS 3.36-3.37 for professional skepticism. Acuity did not discuss what procedures it used to determine the accuracy and validity of the reconciliations prepared and provided by DISA representatives. Acuity only refers to the methodology DISA used to perform the reconciliation. Acuity did not document its basis for concluding the reconciliation is reasonable or reliable.

Therefore, we are unable to agree with Acuity's conclusions regarding the reasonableness of the reconciliation process and do not agree with Acuity's decision to include its review of the pending asset reconciliation process as a justification to reduce the completeness risk to an acceptable level.

- Asset Valuation—Acuity used its asset valuation analysis to support its justification of reducing the completeness risk to an acceptable level. Acuity performed valuation testing on the high-dollar value items from the FY 2011 year-end reconciliations. To conclude the valuations, Acuity performed attribute testing on sampled line items to determine whether a valid Military Interdepartmental Purchase Request exists, the contract amount reconciled, acquisition cost of the asset was supported, and whether the amount paid agrees to the total. Acuity concluded that, based on its testing, the valuations of the program lines were reasonable.

Therefore, Acuity concluded its valuation work could be relied upon to support its justification to reduce the risk with respect to the completeness assertion sufficiently low to conclude that the TSEAS PP&E financial statement line item was not materially misstated due to unrecorded assets.

Based on our review, Acuity conducted attribute testing on five 1790 General Ledger Account Code's and one 1791 General Ledger Account Code. Acuity found no exceptions with any of the samples. However, Acuity did not provide any source documentation to substantiate the results of its testing. AU Section 339.06 states that abstracts or copies of the entity's records should be included as part of the audit documentation if they are needed to enable an experienced auditor to understand the work performed and conclusions reached. Because Acuity did not include any source documentation in its workpapers to support its

conclusions, its workpapers did not meet the standards in AU section 339 for audit documentation. GAGAS, Paragraph 4.19(c), states that audit documentation for financial audits performed in accordance with GAGAS should contain sufficient information to enable an experienced auditor who has had no previous connection with the audit to ascertain from the audit documentation the evidence that supports the auditors' significant judgments and conclusions. Additionally, the U.S. Government Accountability Office and the President's Council on Integrity and Efficiency (GAO/PCIE) FAM 290 states that the auditor must prepare audit documentation in sufficient detail to provide a clear understanding of the work performed (including the nature, extent, and timing and results of audit procedures performed), the audit evidence obtained and its source, and the conclusions reached. Acuity added comment boxes referring to the lack of documentation to support the "Y" or "yes" for their response to the attribute being tested.

Therefore, we determined that because Acuity did not include sufficient documentation to support the results of its analysis, we could not agree with its inclusion of its asset valuation testing to support its justification of reducing the completeness risk to an acceptable level. We then researched Acuity's FY 2008 and FY 2009 TeamMate validation files to determine whether either of these files contained source documentation for the assets. The validation TeamMate files were replicated versions that only contained activated FBWT related workpapers, that is, all of the workpapers related to PP&E were inaccessible in the TeamMate files given to the DoD OIG.

On August 30, 2012, Acuity provided additional supplemental summary workpapers, dated August 29, 2012, that pertained to the FY 2011 audit. The Managing Partner, Acuity stated that it did not appear that this information was considered in our draft report. However, on page 11 through 12 of our draft report, we discuss our review of Acuity's alternative procedures, and although not explicitly stated, Acuity's supplemental summary workpapers were included in our review.

Acuity's Comments on DISA's Financial Statement Footnote Disclosures

The Managing Partner, Acuity stated that the financial statement accompanied by the auditor's report for FY 2011 could have included more complete disclosures for PP&E. The Managing Partner, Acuity quoted AU Section 561 regarding allowance for revisions to issued financial statements. The Managing Partner, Acuity also stated they ensured that DISA made the appropriate corrections and revisions to the note disclosures to the FY 2012 comparative financial statements and they included an explanatory paragraph in the audit report, which was issued November 15, 2012. The Managing Partner, Acuity further stated that as of August 30, 2012, when they discussed these concerns with the DoD OIG, there was no need to reissue the FY 2011 audited financial report because the issuance of the audited financial report for FY 2012 was imminent.

Our Response

It is our opinion that Acuity inappropriately applied the standards set forth in AU section 561.06(b), Subsequent Discovery of Facts Existing at Date of Report, because Acuity was aware of the issues surrounding DISA's financial statements well before the FY 2012 report becoming imminent. We discuss this topic in more detail in the "Our Response" section of "Acuity's Comments on Reissuance of Auditor's Report." We maintain, however, that Acuity should have applied AU Section 561.06(a) and had the FY 2011 financial statements and accompanying auditor's report re-issued.

GAGAS paragraph 3.60 states that auditors must use professional judgment in performing audits and in reporting the results. Although Acuity ensured disclosures were made in the FY 2012 financial statement and auditor's report, it did not provide a response as to why it did not follow AU Section 561.06(a), since it knew of this issue long before the imminent issuance of the FY2012 financial statements and accompanying auditor's report.

AU Section 700.17 states, "The auditor's evaluation about whether the financial statements achieve fair presentation should also include consideration of the following: Whether the financial statements, including the related notes, represent the underlying transactions and events in a manner that achieves fair presentation." Additionally, AU Section 508.10 "Reports on Audited Financial Statements" requires the auditor to add an explanatory language paragraph to the auditor's standard report for when a designated accounting standard setter requires information to accompany an entity's basic financial statements. The fact that Acuity did not disclose this issue in the year the situation existed and the fact that they did not provide an explanation of their decision of why the footnote disclosures were not necessary, calls into question Acuity's use of professional judgment in reporting of the results and ultimately the reliability of their audit opinion on the FY 2011 financial statements. Therefore, Acuity did not comply with the standards set forth in AU Section 508, AU Section 561.06(a), AU Section 700.17, GAGAS3.32 and GAGAS 3.60.

Acuity's Comments on DISA's Informative Disclosures

The Managing Partner, Acuity stated that DoD Financial Management Regulation is not relevant as a standard in discussing the financial statement audit conducted by Acuity and is neither a part of the U.S. Generally Accepted Accounting Principles hierarchy or professional auditing standards. The Managing Partner, Acuity stated that the financial statement accompanied by the auditor's report for FY 2011 could have included more complete disclosures for PP&E. The Audit Partner, Acuity quoted AU 561 regarding allowance for revisions to issued financial statements. The Audit Partner, Acuity also stated they ensured that DISA made the appropriate corrections and revisions to the note disclosures to the FY 2012 comparative financial statements and they included an explanatory paragraph in the audit report, which was issued November 15, 2012. The Audit Partner, Acuity stated that as of August 30, 2012, when they discussed these

concerns with the DoD OIG, there was no need to reissue the FY 2011 audited financial report because the issuance of the audited financial report for FY 2012 was imminent.

Our Response

The Federal Accounting Standards Advisory Board hierarchy of accounting principles and standards are used to promulgate DoD accounting and financial reporting policy within the DoD FMR. While it is true that the DoD FMR is not a standard for auditors, Acuity should have been aware of the responsibility of DISA to prepare its financial statements in accordance with the DoD FMR. Additionally, the GAO/PCIE FAM 245 requires auditors to design relevant compliance related audit procedures to identify the significant provisions of the laws and regulations.

The DoD FMR directs statutory and regulatory financial management requirements for working capital fund activities of the DoD. DISA is required to present financial information that not only complies with Generally Accepted Accounting Principles, but also complies with the requirements of the DoD FMR. Because the grouped asset cost method and the activation and depreciation method deviates from the policy for recording PP&E in the DoD FMR, DISA was required to provide explanatory language about its method in the notes to the financial statements or the Management's Discussion and Analysis section of the financial statements. Because DISA did not disclose this information, the FY 2011 financial statements did not comply with the Office of Management and Budget Circular A-136, 2010 revision, section II.4.9.1 and the Chief Financial Officer's Act of 1990, 31 U.S.C. Section 902 as required by law. Furthermore, AU Section 508.10, "Reports on Audited Financial Statements" requires the auditor to add an explanatory language paragraph to the auditor's standard report when a designated accounting standard setter requires information to accompany an entity's basic financial statements.

It is our opinion that Acuity inappropriately applied the standards set forth in AU section 561, Subsequent Discovery of Facts Existing at the Date of Report, because Acuity was aware of the issues surrounding DISA's financial statements prior to FY 2012 report becoming imminent. We discuss this topic in more detail in the "Our Response" section of "Acuity's Comments on Reissuance of Auditor's Report."

Acuity's Comments on DISA Not Disclosing the Grouped Asset Cost Method

The Managing Partner, Acuity stated that the financial statement accompanied by the auditor's report for FY 2011 could have included more complete disclosures for PP&E. The Managing Partner, Acuity quoted AU Section 561 regarding the allowance for subsequent disclosures to issued financial statements. The Managing Partner, Acuity also stated that they ensured DISA made the appropriate corrections and revisions to the note disclosures to the FY 2012 comparative financial statements and they included an explanatory paragraph in the audit report, which was issued November 15, 2012. The Managing Partner, Acuity stated that as of August 30, 2012, when they discussed concerns with the DoD OIG, no need existed to reissue the FY 2011 audited financial

report because the issuance of the audited financial report for FY 2012 was imminent. The Managing Partner, Acuity also stated that DoD Financial Management Regulation is not relevant as a standard in discussing the financial statement audit conducted by Acuity and is neither a part of the U.S. Generally Accepted Accounting Principles hierarchy or professional auditing standards.

Our Response

DISA did not disclose the grouped asset cost method in FY 2011. The DoD FMR directs statutory and regulatory financial management requirements for working capital fund activities of the DoD. DISA is required to present financial information that not only complies with Generally Accepted Accounting Principles but that also complies with the requirements of the DoD FMR. Because the grouped asset cost method deviates from the policy for recording PP&E in the DoD FMR, DISA was required to provide explanatory language about its method in the notes to the financial statements and or the Management's Discussion and Analysis section of the financial statements. Because DISA did not disclose this information, the FY 2011 financial statements did not comply with the Office of Management and Budget Circular A-136, 2010 revision, section II.4.9.1 and the Chief Financial Officer's Act of 1990, 31 U.S.C. Section 902 as required by law.

The Federal Accounting Standards Advisory Board hierarchy of accounting principles and standards are used to promulgate DoD accounting and financial reporting policy within the DoD FMR. While it is true that the DoD FMR is not a standard for auditors, Acuity should have been aware of the responsibility of DISA to prepare its financial statements in accordance with the DoD FMR. Additionally, the GAO/PCIE FAM 245 requires auditors to design relevant compliance related audit procedures to identify the significant provisions of the laws and regulations.

Acuity's Comments on DISA Not Disclosing the Grouped Asset Activation and Depreciation Method

The Managing Partner, Acuity stated that the financial statement accompanied by the auditor's report for FY 2011 could have included more complete disclosures for PP&E. The Managing Partner, Acuity quoted AU Section 561 regarding the allowance for subsequent disclosures to issued financial statements. The Managing Partner, Acuity also stated they ensured that DISA made the appropriate corrections and revisions to the note disclosures to the FY 2012 comparative financial statements and they included an explanatory paragraph in the audit report, which was issued November 15, 2012. The Managing Partner, Acuity stated that as of August 30, 2012, when Acuity discussed concerns with the DoD OIG, no need existed to reissue the FY 2011 audited financial report because the issuance of the audited financial report for FY 2012 was imminent. The Managing Partner, Acuity also stated that DoD Financial Management Regulation is not relevant as a standard in discussing the financial statement audit conducted by Acuity and is neither a part of the U.S. Generally Accepted Accounting Principles hierarchy or professional auditing standards.

Our Response

DISA did not disclose the grouped asset activation and depreciation method in FY 2011. The DoD FMR directs statutory and regulatory financial management requirements for working capital fund activities of the DoD. DISA is required to present financial information that not only complies with Generally Accepted Accounting Principles but that also complies with the requirements of the DoD FMR. Because the grouped asset activation and depreciation method deviates from the policy for recording PP&E in the DoD FMR, DISA was required to provide explanatory language about its method in the notes to the financial statements and or the Management's Discussion and Analysis section of the financial statements. Because DISA did not disclose this information, the FY 2011 financial statements did not comply with the Office of Management and Budget Circular A-136, 2010 revision, section II.4.9.1 and the Chief Financial Officer's Act of 1990, 31 U.S.C. Section 902 as required by law.

The Federal Accounting Standards Advisory Board hierarchy of accounting principles and standards are used to promulgate DoD accounting and financial reporting policy within the DoD FMR. While true the DoD FMR is not a standard for auditors, Acuity should have been aware of the responsibility of DISA to prepare its financial statements in accordance with the DoD FMR. The GAO/PCIE FAM 245 requires auditors to design relevant compliance related audit procedures to identify the significant provisions of the laws and regulations.

Acuity's Comments on Contracting Officer's Representative's Key Oversight Duties

The Managing Partner, Acuity stated the DoD OIG report is inaccurate based on the following reasons:

- The COR reviewed very little of the work performed and provided essentially no feedback beyond the Plan of Action and Milestones.
- The audit plan was not a contract deliverable, but was provided to the COR within 2 months of the request.
- The timing and delivery of the audit plan was consistent with the timeline presented in the draft report and was representative of typical audit planning for a first-year audit of a client of this complexity and size.

Our Response

We have addressed our concerns about the contract oversight performed by the COR with DISA management. However, the Managing Partner, Acuity stated that the audit plan was not a contract deliverable and was delivered within 2 months of the request.

GAO/PCIE FAM section 210, "Overview of the Planning Phase" states that the auditor must adequately plan the audit work and the auditor should develop effective and efficient ways to obtain the sufficient appropriate evidence necessary to report on the federal entity's financial statements. The Managing Partner, Acuity stated that the audit plan was provided to the COR within 2 months of the request, yet, Acuity's audit

documentation shows that their draft audit plan is dated February 11, 2011. Additionally, the COR provided us with the audit plan received from Acuity, also dated February 11, 2011, which is 4 months after the contract was awarded.

Acuity's Comments on Reissuance of Auditor's Report

The Managing Partner, Acuity stated they disagree that the audit report requires reissuance. The Managing Partner, Acuity stated that the DoD OIG's application of AU Section 561, Subsequent Discovery of Facts, is incorrect and that the correct standard to apply first is AU Section 390, Consideration of Omitted Procedures After the Report Date. The Managing Partner, Acuity concluded there was no impairment to their ability to support and provide a satisfactory basis for their previously expressed opinion, but the issue regarding complete note disclosures for FBWT and PP&E could have affected the FY 2011 report.

The Managing Partner, Acuity stated on August 30, 2012, this information was provided to the DoD OIG, but evidently was not considered in developing their draft report. The Managing Partner, Acuity stated they ensured that DISA made the appropriate corrections and revisions to the note disclosures to the FY 2012 comparative financial statements and included an explanatory paragraph in the audit report, which was issued November 15, 2012. In addition, the Managing Partner, Acuity stated since this is within 90 days of the issuance of the FY 2012 audited financial report, reissuance of the FY 2011 financial audit report is neither necessary nor appropriate.

Our Response

As identified in our draft report on page 16, we discussed the application of AU Section 390, Consideration of Omitted Procedures, prior to our discussion of AU Section 561, Subsequent Discovery of Facts Existing at Date of Report. AU Section 390 states, "When the auditor concludes that an auditing procedure considered necessary at the time of the audit in the circumstances then existing was omitted from his audit of financial statements, he should assess the importance of the omitted procedures to his present ability to support his previously expressed opinion regarding those financial statements taken as a whole."

AU Section 390 further states, "When, as a result of the subsequent application of the omitted or alternative procedures, the auditor becomes aware that facts regarding the financial statements existed at the date of his report that would have affected that report had he been aware of them, he should be guided by the provisions of AU Section 561.05-09, Subsequent Discovery of Facts Existing at the Date of the Auditor's Report." Acuity was aware of the issues surrounding DISA's financial statements we identified in our report long before imminent issuance of the FY 2012 financial statements and accompanying auditor's report. Therefore, Acuity's application of AU Section 561.06(b) does not apply and AU Section 561.06(a) does apply.

The Managing Partner, Acuity stated that after review of AU Section 390, they concluded there was no impairment to support their expressed opinion, but the issue regarding

complete note disclosures for FBWT and PP&E could have affected the FY 2011 report. The Managing Partner, Acuity stated they ensured that DISA made the appropriate corrections and revisions to the note disclosures to the FY 2012 comparative financial statements and included an explanatory paragraph in the audit report, which was issued November 15, 2012. After review of all evidence provided by Acuity, we concluded that procedures omitted by Acuity in performing the DISA FY 2011 financial statement audit, impairs its ability to support its previously expressed opinion regarding the financial statements taken as a whole.

Acuity's Comments on DISA Contract Required Acuity Compliance with Government Auditing Standards

The Managing Partner, Acuity stated they disagree that Acuity did not comply with GAGAS. The Managing Partner, Acuity stated they designed a risk based audit approach in accordance with audit standards including, AU 318 Performing Audit Procedures in Response to Assessed Risk; AU326 Audit Evidence, AU 339 Audit Documentation, and AU 508 Reports on Audited Financial Statements. The Managing Partner also stated that they obtained sufficient and appropriate evidence to support their conclusion and provide reasonable bases for their opinion. The Managing Partner, Acuity stated they considered the effectiveness of management's responses and controls to address the risks. The Managing Partner, Acuity also stated they appropriately documented their understanding, and their work followed appropriate standards, including GAGAS, GAO/PCIE FAM, and AICPA standards.

Our Response

The DoD OIG has cited numerous examples throughout our report where Acuity did not comply with GAGAS. Specifically, Acuity did not comply with GAGAS, Paragraph 4.19(c), because they:

- did not include the validation of the CMR in its audit documentation, which would have required them to obtain and document all of the detail transactions supporting the summary amounts on the CMR,
- did not explicitly discuss the risk, materiality, and impact of the MFRs on the financial statements, and
- did not provide supporting documentation for the \$37.7 million TSEAS assets tested to show how the auditor reached their conclusions.

Acuity did not comply with GAGAS paragraph 4.03 because they:

- only performed summary reconciliations of the FBWT account and did not adequately test to ensure DISA was performing regular and recurring FBWT reconciliations at the detailed level,
- accepted a response from DISA regarding the deficiencies in the undistributed accounts, but did not perform any follow up work on the account to ensure the undistributed accounts could be supported, and

- accepted the deficiencies DISA reported in the MFRs without performing adequate auditing procedures to determine if the deficiencies would have a material impact on the FWT account.

Acuity did not comply with GAGAS chapter 5.03(c) because they did not state in their auditor's report that the DISA financial statement footnote disclosures were inadequate. Additionally, the FAM section 290 requires the auditor to prepare audit documentation in sufficient detail to provide a clear understanding of the work performed (including the nature, extent, and timing and results of audit procedures performed), the audit evidence obtained and its source, and the conclusions reached.

AU Section 326.20 "Procedures for Obtaining Audit Evidence" states that the auditor should obtain audit evidence to draw reasonable conclusions on which to base the audit opinion by performing audit procedures to detect material misstatements at the relevant assertion level. Audit procedures performed for this purpose are referred to as substantive procedures and include tests of details of classes of transactions, account balances, and disclosures, and substantive analytical procedures. The auditor must perform risk assessment procedures to provide a satisfactory basis for the assessment of risks at the financial statement and relevant assertion levels. Risk assessment procedures by themselves do not provide sufficient appropriate audit evidence on which to base the audit opinion and must be supplemented by further audit procedures in the form of tests of controls, when relevant or necessary and substantive procedures.

Acuity did not subject the FWT line item to adequate auditing procedures. Specifically, Acuity did not properly test the DISA FWT reconciliations. AU Section 326.04 states that the auditor should obtain audit evidence by testing the accounting records through analysis and review, and reperforming procedures followed in the financial reporting process and reconciling related types of the same information. Additionally, AU Section 326.06, "Sufficient Appropriate Audit Evidence" states that audit evidence is more reliable when it is obtained from knowledgeable independent sources outside the entity and that corroborating information obtained from a source independent of the entity may increase the assurance the auditor obtains from management representations.

A proper FWT reconciliation would require that DISA retrieve the disbursement and collection transactions processed by the disbursing offices to: support the summary amounts on the CMR; reconcile the disbursements and collections supporting the CMR to the disbursements and collections reported in the accounting system; and research, and if necessary, resolve any variances between the transactions supporting the CMR and the transactions in the accounting system. However, Acuity only:

- obtained the detail transactions recorded in the accounting system (but did not obtain the detail transactions supporting the CMR), and
- summed the transactions in the accounting system and compared that summary amount to the summary amount supporting the CMR

Acuity also acknowledged that it did not include the validation of the CMR in its audit documentation, which would have required it to obtain and document all of the detail transactions supporting the summary amounts on the CMR. Because Acuity did not obtain and document the detail transactions supporting the summary amounts within the CMR, Acuity failed to adhere to the standards in AU Section 326.

In addition AU Section 339 “Audit Documentation” requires the auditor to prepare audit documentation in connection with each engagement in sufficient detail to provide a clear understanding of the work performed (including the nature, timing, extent, and results of audit procedures performed), the audit evidence obtained and its source, and the conclusions reached.

Acuity selected 6 high-dollar value assets valued at \$37.7 million, out of 31 TSEAS assets valued at \$49.3 million in the PP&E 1790 and 1791 general ledger account balances. Of the six assets tested, the auditor found no discrepancies with the samples, but provided no supporting documentation to show how the auditor reached its conclusions. Therefore, Acuity failed to adhere to the standards in AU Section 339.

Additionally, AU Section 508.10 “Reports on Audited Financial Statements” requires the auditor to add an explanatory paragraph to the auditor’s standard report when a designated accounting standard setter requires information to accompany the entity’s basic financial statements, while not affecting the auditor’s unqualified opinion on the financial statements. Because Acuity was aware that DISA did not disclose the group asset cost and activation and depreciation method and did not disclose this information in an explanatory language paragraph in the report, Acuity did not comply with the standards set forth in AU section 508.

Defense Information Systems Agency Comments



DEFENSE INFORMATION SYSTEMS AGENCY
P. O. BOX 549
FORT MEADE, MARYLAND 20755-0549

IN REPLY REFER TO Vice Director (DV)

FEB 01 2013

MEMORANDUM FOR DEPARTMENT OF DEFENSE INSPECTOR GENERAL

SUBJECT: Defense Information Systems Agency (DISA) comments and responses to the Draft Audit Opinion Report of the DISA FY 2011 Working Capital Fund Financial Statements Was Not Adequately Supported, January 8, 2013, (Project No. D2012FH-0122)

1. We appreciate the DoD IG's review and comments and will use this valuable input as we seek to attain sustainable audit readiness. The Agency's first ever assertion for Audit validated many of our processes and procedures while providing a significant learning opportunity. While not perfect, the Agency is much better off for having submitted for Audit, having now developed greatly improved internal management controls and put a process in place for continuous improvement. This feedback is invaluable and will help DISA improve this aspect of Agency internal controls. We have reviewed the draft report referenced above and provide the enclosed comments.
2. We look forward to working with you and your staff in the future. Any questions your staff may have concerning matters for the recommendations should be directed to [REDACTED]. Please do not hesitate to contact [REDACTED] should you need to further discuss this matter.

Enclosure a/s

DAVID G. SIMPSON
Rear Admiral, USN
Vice Director

Defense Information Systems Agency (DISA) responses to the
Draft Audit Opinion Report on the DISA FY 2011 Working Capital Fund Financial
Statements Was Not Adequately Supported, dated January 8, 2013,
(Project No. D2012-D000FH-0122.000)

PREFACE:

Your review has illuminated the importance of clear delineation of roles and responsibilities in the management of the IPA contract and best practices in writing effective IPA audit services contract language. DISA's review of the actions of the Director, PLD found that the COR and PLD Director strictly interpreted their individual responsibilities in the execution of the IPA contract effort with the COR focusing on the auditing standards and the PLD Director focusing on the stated deliverables. In future audits, as evidenced by the FY2012 audit contract, DISA will ensure appropriate language is incorporated into contract deliverables. We will be interested in DoD IG's assessment of the FY12 audit to determine if adjustments made were sufficient.

DISA COMMENTS TO RECOMMENDATIONS:

RECOMMENDATION 1.a: The Director, DISA should review the actions of the Director, Procurement and Logistics Directorate to determine whether they acted within the scope of their authority and take appropriate corrective action as necessary.

DISA RESPONSE: Concur

We are reviewing the actions of the Procurement and Logistics Directorate (PLD). Please note that the Director, PLD has been designated as the Head of Contracting Activity (HCA) for DISA and has been delegated all procurement authorities of the Director of DISA, including authority to enter into and administer contracts. As required by the Federal Acquisition Regulations, including the DoD Supplement, the Contracting Officer's Representative (COR) was designated and authorized by the contracting officer (see FAR 1.602-2, DFARS 201.602-2, and DFARS PGI 201.602-2). The contracting officer has the responsibility to specify the duties of the COR and has the authority to adjust those duties as needed. Adjustment of the COR's duties is within the scope of the authority of the contracting officer, thus corrective action on the issue of authority is not necessary.

Estimated Completion Date: February 1, 2013

RECOMMENDATION 1.b: Ensure that the responsibilities of individuals performing contract oversight of financial statement audits are fulfilled by a qualified, General Schedule 0511 series Defense Information Systems Agency employee.

DISA RESPONSE: Concur.

Concur that the individuals performing contract oversight of financial statement audits will be fulfilled by qualified DISA employees. We will use employees, including General Schedule 0511 employees and other qualified employees, depending on the duties that need to be performed. We currently have seven GS 0511 personnel assigned to the Agency that would be available for COR duties.

Estimated Completion Date: February 1, 2013

RECOMMENDATION 1.c: Seek a refund from Acuity Consulting, Inc. for the audit services not provided on the Defense Information Systems Agency FY 2011 Working Capital Fund Financial Statements contract.

DISA RESPONSE:

DISA believed throughout execution of the auditing service contract effort that the IPA was fulfilling its legal contract requirements. DISA continues to review this matter. The review will include the contract documentation, the DoD IG audit work papers, and any response to this audit by the contractor to determine if there is a basis to assert that the provisions of the contract were not complied with. As part of this review, DISA will have to determine whether there is a basis to seek a refund given that performance of the contract is complete. If DISA determines that there is reason to seek a refund, we will need the support of the Department in pursuing that remedy.

Estimated Completion Date: March 31, 2013



Acuity Consulting, Inc. Comments

DOUGLAS & BOYKIN PLLC

February 8, 2013

By Courier & Email

Office of the Inspector General
Department of Defense
4800 Mark Center Drive
Alexandria, VA 22350

Re: The Audit Opinion of the DISA FY 2011 Working Capital Fund Financial Statements Was Not Adequately Supported (Project No. D2012-D000FH-0122.000)

Dear [REDACTED]:

This letter transmits Acuity's comments to the Office's findings and recommendations in the referenced report. The Office recommends that Acuity withdraw its unqualified opinion of the Defense Information Systems Agency FY 2011 Working Capital Fund Financial Statements. (Recommendation 2.a.) Acuity does not believe it is necessary to withdraw its opinion because based on the procedures performed, the risk of material misstatement is low.

Acuity's position is explained fully in the enclosed comments prepared and executed by Acuity. The comments are also supplemented by the enclosed DVD of DISA FY2011 workpapers that explicate the referenced material. The DVD is provided to ensure the DoDIG has the latest version of the workpapers which includes any revisions made as a result of Acuity's quality review process. Any changes made did not impact the substance of any audit workpapers with the exception of workpaper 4000C.10 related to the trend analysis of the FBWT undistributed reconciliation, inadvertently omitted from the original workpapers.

The Office also recommends that Acuity review its planned work on future audits and incorporate the appropriate audit steps into its audit plan to gather sufficient evidence to support its opinion. (Recommendation 2.b.) Acuity is mindful of the importance of each plan being designed to meet the real-world issues of an audit. Where the purpose of the audit is, for example, to verify the factual existence of objects, then it may be appropriate to verify all external sources. When, as here, the purpose is to design a risk based approach then it is appropriate to exercise professional judgment as to what constitutes sufficient appropriate audit evidence by considering factors such as the significance of the potential misstatement in the relevant assertion and the likelihood of its having a material effect, individually or aggregated with other potential misstatements, on the financial statements. Acuity considered other factors in its audit approach including:

[REDACTED]
www.douglasboykin.com

DOUGLAS&BOYKIN PLLC

[REDACTED]

Office of the Inspector General

*Re: The Audit Opinion of the DISA FY 2011 Working Capital Fund Financial Statements Was Not
Adequately Supported (Project No. D2012-D000FH-0122.000)*

February 8, 2013

Page 2 of 2

- the effectiveness of management's responses and controls to address the risks;
- the experience it has gained during previous audits (which, as a matter of course, Acuity uses to continuously improve its audit documentation); and
- their understanding of DISA and its environment of internal controls, the source and reliability of available information; and the persuasiveness of audit evidence.

Acuity's audit plan was appropriate given the purpose of the audit. Acuity designed its risk-based approach in accordance with audit standards (*to wit*, AU§318, *Performing Audit Procedures in Response to Assessed Risk*; AU§326, *Audit Evidence*; AU§339, *Audit Documentation*; and AU§508, *Reports on Audited Financial Statements*). Further, execution of the audit plan enabled Acuity to obtain sufficient evidence to support its conclusions and provide a reasoned basis for its opinion. As is fully explained in the enclosed comments and clarifying information, Acuity met the applicable auditing standards. Accordingly, Acuity respectfully disagrees with the OIG's conclusion that it should withdraw its unqualified opinion.

Sincerely,



Frederick A. Douglas

Enclosures: (2) (Acuity Comments; accompanying DVD transmitted only with hard copy letter, not email).

Cc: [REDACTED], Acuity

ACUITY COMMENTS

The Audit Opinion of the DISA FY 2011, Working Capital Fund Financial Statements Was Not Adequately Supported, Project No. D2012-D000FH-0122.000

OVERALL COMMENTS

Acuity designed a risk-based approach to its audit of the DISA FY 2011 Working Capital Fund Financial Statements in accordance with audit standards including: AU§318, *Performing Audit Procedures in Response to Assessed Risk*; AU§326, *Audit Evidence*; AU§339, *Audit Documentation*; and AU§508, *Reports on Audited Financial Statements*. We obtained sufficient and appropriate audit evidence to support our conclusions and provide a reasonable basis for our opinion. Our professional judgment as to what constituted sufficient appropriate audit evidence was influenced by factors such as the significance of the potential misstatement in the relevant assertion and the likelihood of its having a material effect, individually or aggregated with other potential misstatements, on the financial statements. Additionally, we considered: the effectiveness of management's responses and controls to address the risks; the experience we gained during previous audits; our understanding of DISA and its environment, including its internal controls; the source and reliability of available information; and the persuasiveness of the audit evidence.

The Department of Defense (DoD) Office of the Inspector General (DoDIG) report contained misstatements about and mischaracterizations of our audit work and, in some instances, presented information incorrectly or out of context. In addition, the DoDIG did not consider all relevant information Acuity provided to help the DoDIG understand Acuity's audit approach and procedures. We respectfully request that DoDIG reconsider its position stated in the draft report.

FINDING: ACUITY'S AUDITING PROCEDURES TO SUPPORT THEIR OPINION ON THE DISA FY 2011 WORKING CAPITAL FUND FINANCIAL STATEMENTS WERE NOT EFFECTIVE

DoDIG Report: *Acuity did not have sufficient evidence to issue an unqualified opinion on the DISA FY 2011 WCF Financial Statements. Furthermore, without performing procedures that ensure compliance with GAGAS, FAM, and AICPA standards, the DoD does not have assurance that the DISA FY 2011 Financial Statements are free of material misstatements.*

Acuity Response: Per AU§318, AU§326, AU§339, and AU§508, Acuity considered the risk of material misstatement associated with each material assertion, account, or class of transactions and obtained sufficient and appropriate evidence to reduce the risk of material misstatement to an acceptable level. In our professional judgment, we had sufficient and appropriate evidence to provide a reasonable basis for an unqualified opinion on the DISA FY 2011 WCF Financial Statements. Our audit was designed and conducted in accordance with AICPA standards, GAGAS, and the GAO/PCIE Financial Audit Manual.

Acuity respectfully disagrees with the DoDIG's position because the procedures performed complied with GAGAS, FAM, and AICPA standards.

ECD: N/A.

Acuity Did Not Perform Sufficient Audit Procedures to Support Their Audit Opinion

DoDIG Report: Acuity did not perform key audit procedures to support the audit opinion on the DISA FY 2011 WCF Financial Statements. Specifically, Acuity's procedures used to test the DISA FBWT account and PP&E line item were inadequate.

Acuity Response: Acuity respectfully disagrees with the DoDIG's position because the procedures performed complied with GAGAS, FAM, and AICPA standards. Per AU§318, AU§326, AU§339, and AU§508, Acuity considered the risk of material misstatement associated with each material assertion, account, or class of transactions and obtained sufficient and appropriate evidence to reduce the risk of material misstatement to an acceptable level. In our professional judgment, we had sufficient and appropriate evidence to provide a reasonable basis for an unqualified opinion on the DISA FY 2011 WCF Financial Statements. Our audit was designed and conducted in accordance with AICPA standards, GAGAS, and the GAO/PCIE Financial Audit Manual. For details related to FBWT and PP&E, see the specific comments written below.

ECD: N/A.

Acuity's Procedures for Auditing the DISA FBWT Account Were Inadequate

DoDIG Report: Acuity did not perform adequate auditing procedures on the FBWT account.

Acuity Response: See details in the following subsections.

ECD: N/A.

Acuity Did Not Properly Test DISA FBWT Reconciliations

DoDIG Report: Acuity's procedures for auditing the DISA FBWT reconciliations were inadequate.

Acuity Response: The report does not articulate why DoDIG believes Acuity's FBWT reconciliation testing procedures might result in an unacceptable risk of material misstatement. To the extent DoDIG is concerned about the risk of material misstatement related to unrecorded collections and disbursements, Acuity's audit approach controlled this risk to an acceptable level. Acuity performed a risk-based and standards-based audit approach in accordance with AU§318, AU§326, and AU§339. We employed a variety of complementary procedures and independently validated the FBWT reconciliations. We performed substantive audit procedures related to the financial statement reporting process by: reconciling the financial statements (in this case, the FBWT trial balances, as the balance sheet reports \$0 for FBWT) to the underlying accounting records (*i.e.*, accounting system subsidiary ledgers for disbursements and collections); examining

material journal entries and other adjustments related to FBWT; relying upon our experience gained in previous audits and our historical experience with DISA (*e.g.*, examining and/or auditing four years of their financial records); and considering the source and reliability of the audit evidence. Specifically, Acuity:

- Observed DISA's FBWT reconciliation processes and reviewed them.
- Performed an independent reconciliation of FBWT and the Cash Management Report (CMR), including detailed substantive and internal control testing of collection and disbursement transactions.
- Performed a reconciliation of CMR cash activity to the AR(M) 1307 Report and Net Outlays on the SF 133.
- Examined and performed an independent reconciliation of the DFAS-Indianapolis (DFAS-IN) SF 133 Reconciliation to the Cash Balance at the .05 level, which was from a reliable independent source.
 - Confirmed the summary collection and disbursement amounts reported in the DFAS-IN SF 133 Reconciliation at the .05 level agreed to the accounting system subsidiary ledger collection and disbursement transactions.
 - Performed complementary substantive and internal control testing (including various analytical procedures) of collections and disbursement detail transactions in conjunction with the revenue and expense cycle audit procedures. We tested a significant number of detailed collection and disbursement transactions during both interim and year-end testing, which identified no significant control weaknesses or discrepancies regarding the completeness of collection and disbursement transactions. Also, we performed cut-off testing of collections and disbursements at year-end in conjunction with our revenue and expense cycle audit procedures, which provided a reasonable basis to conclude a lower risk of material misstatement related to missing or incomplete collection and disbursement transactions.
- Reconciled the ending Defense Working Capital Fund (DWCF) FBWT balance to the balance reported on the GWA, another reliable independent source (*i.e.*, U.S. Department of Treasury).

To address the DoDIG's questions and clarify points apparently misunderstood, we prepared supplemental summary workpapers subsequent to the audit to more clearly document the work performed and tie related work together to facilitate a review by an independent reviewer. On August 30, 2012, we provided these workpapers to the DoDIG. We respectfully request that the DoDIG consider these supplemental workpapers in its present review and update the draft report to reflect consideration of these documents Acuity provided to further clarify our audit approach for the DoDIG.

Acuity's audit approach, which included detailed internal control and substantive testing of collection and disbursement transactions and corroborating audit evidence from independent sources, provides a reasonable basis to manage the risk of material misstatement related to unrecorded collection and disbursement transactions.

In summary, Acuity respectfully disagrees the work was inadequate. The procedures performed complied with GAGAS, FAM, and AICPA standards.

WP References: 4000C.10; 5000F.15A.1; 5000F.15A.2

ECD: N/A.

Acuity Did Not Determine Whether the Undistributed Accounts Were Free of Material Misstatement

DoDIG Report: Acuity did not determine whether the TSEAS and Computer Services Directorate (CSD) "Undistributed Disbursements" accounts were free of material misstatements. Acuity determined that the balances in the TSEAS undistributed account, totaling \$15.3 million and the CSD undistributed account, totaling \$929 thousand, were both above the allocated materiality threshold for the FBWT account. However, Acuity did not adequately follow up on the identified deficiencies.

Acuity Response: The report does not specifically articulate why DoDIG believes Acuity's procedures might result in an unacceptable risk of material misstatement. To the extent DoDIG is concerned about the risk of material misstatement related to improper or incorrect disbursements, Acuity controlled this risk to an acceptable level. Acuity performed a risk-based and standards-based audit approach in accordance with AU§318, AU§326, and AU§339. We employed a variety of complementary substantive audit procedures throughout the audit related to the financial statement reporting process by: agreeing the accounts payable financial statement line item to the underlying accounting records (*i.e.*, accounting system subsidiary ledgers for accounts payable undistributed disbursements); examining material journal entries and other adjustments related to accounts payable undistributed disbursements; and relying upon our experience gained in other DoD audits and our historical experience with DISA (*e.g.*, examining and/or auditing four years of accounts payable undistributed disbursements). We also considered the effectiveness of management's responses and controls to address the risks as they matured their processes and procedures based upon Acuity's previously issued notifications of findings. Specifically, Acuity:

- Performed interim tests of the accounts payable undistributed accounts as part of baseline testing and throughout the year, including Q2 (CSD), Q3 (CSD and TSEAS), and Q4 (CSD and TSEAS), which identified DISA's continuous improvement in analyzing and understanding the nature of the transactions in this account and the resulting ability to reduce the volume of transactions and value of accounts payable undistributed disbursements.
- Performed audit procedures that provided sufficient and appropriate evidence to provide a reasonable basis for the conclusion regarding accounts payable undistributed disbursements.

We performed an audit procedure to analyze the accounts payable undistributed disbursement transaction activity in October 2011, comparing to the transactions comprising the reported balance on September 30, 2011, and determined the related transactions had cleared through the normal process. The audit procedure was performed subsequent to the issuance of our report in

accordance with AU§390, Consideration of Omitted Procedures After the Report Date, concluding the risk of material misstatement related to accounts payable undistributed disbursements was minimal. We documented this in the workpapers and on August 30, 2012, provided them to the DoDIG.

It appears the DoDIG did not consider the results of the subsequently performed procedure or our conclusion there was no risk of material misstatement. Since the risk of material misstatement was low, the omitted procedure had no impact on our previously issued unqualified opinion. We respectfully request that the DoDIG consider these supplemental workpapers in its present review and update the draft report to reflect consideration of these documents Acuity provided to further clarify our audit approach for the DoDIG.

Acuity's audit approach—which included consideration of DISA's responsiveness to concerns we identified in their accounts payable undistributed disbursements; and the internal control and substantive audit procedures performed during interim, year-end, and subsequent to the audit report date—provides a reasonable basis to manage the risk of material misstatement related to improper or incorrect accounts payable undistributed disbursement transactions.

Therefore, Acuity respectfully disagrees with DoDIG's conclusion that Acuity did not adequately follow up on the identified deficiencies.

WP References: 2500.03a.1

ECD: N/A.

Acuity Did Not Address Material Audit Trail Deficiencies

DoDIG Report: *Acuity did not adequately assess whether the deficiencies identified by DISA in its FBWT MFRs would have a material impact on the financial statements and ultimately Acuity's opinion.*

Acuity Response: The report does not specifically articulate why DoDIG believes the FBWT MFR deficiencies would impact Acuity's opinion. Acuity controlled the risk of material misstatement related to the beginning FBWT balance to an acceptable level. Acuity performed a risk-based and standards-based audit approach in accordance with AU§318, AU§326, AU§339, and AU§342, *Auditing Accounting Estimates*. Specifically, Acuity:

- Conducted a thorough review of the documentation and data provided by DISA in support of the MFRs, which is documented in the workpapers. Also, we consulted with an expert in the field of FBWT reconciliations.
- Determined the risk of material misstatement was sufficiently low to provide a reasonable basis for an unqualified opinion based on DISA FBWT (*i.e.*, collection and disbursement) internal controls in place since FY 2007.
- Determined the FBWT baseline/MFR process was a significant issue because it involved complex transactions and there was difficulty in applying audit procedures due to the lack of documentation. In this situation, the original source documentation supporting disbursements and collections prior to FY 2007 was no longer available. Because this

occurred prior to the audit, we would have had no opportunity to request that DISA maintain this documentation for future audit. In our professional judgment, we applied appropriate procedures to test the internal controls on the FBWT reconciliation process and the collection and disbursement transactions. We relied upon our experience and familiarity with DISA from examining and/or auditing four years of their financial records. Further, we validated the reasonableness of DISA's baseline approach documented in the MFRs, which was further corroborated by DFAS, an independent source, who participated in documenting the baseline and audit trail in the MFR process.

- Evaluated the reasonableness of the estimated beginning balances, concentrating on key factors and assumptions significant to the accounting estimates, such as the cash rebuild adjustments of \$3.9 million (net) for TSEAS and \$186.9 million for CSD. Acuity also considered the estimated beginning balances and assumptions relative to the experiences we had with other DoD clients and specifically with DISA collections and disbursements for fiscal years 2008-2011. Further, we considered the potential bias that may be introduced by the client by considering corroborating information from and participation by DFAS, an independent source.

Although we fully assessed the MFR deficiencies, we determined we did not clearly document all of our conclusions. Accordingly, we prepared supplemental summary workpapers, which referenced and linked the MFR workpapers in the baseline section of the FY 2011 TeamMate project file, and clarified our conclusions with respect to the MFRs. On August 30, 2012, we provided the supplemental summary workpapers with our fully documented conclusions to the DoDIG, and noted that workpapers documenting the work performed on the FBWT MFR were in the FY 2010 baseline procedures section of the FY 2011 audit workpapers. It does not appear this information was considered in the draft report. We respectfully request that the DoDIG consider these supplemental workpapers in its present review and update the draft report to reflect consideration of these documents Acuity provided to further clarify our audit approach for the DoDIG.

The financial statements accompanied by the auditor's report for FY 2011 could have included an explanatory paragraph of emphasis and more complete disclosures for FBWT. AU§561.06.a. allows for revision of only the most recently issued financial report, while AU§561.06.b. states that "when issuance of financial statements accompanied by the auditor's report for a subsequent period is imminent ... appropriate disclosure of the revision can be made ... instead of reissuing the earlier statements." Acuity ensured that DISA made the appropriate corrections and revisions to the note disclosures to the FY 2012 comparative financial statements and we included an explanatory paragraph in the audit report, which was issued November 15, 2012. Accordingly, Acuity does not believe reissuance of the FY 2011 audited financial report is warranted.

WP References: 2400.50

ECD: N/A.

Acuity's Reliance on DISA Management

DoDIG Report: Acuity relied on representations from management and did not independently validate the representations made by DISA.

Acuity Response: AU§220, *Independence*, states the “auditor must maintain independence in mental attitude in all matters relating to the audit.” AU§230, *Due Professional Care in the Performance of Work*, requires the auditor to exercise professional skepticism. Acuity was unbiased with respect to DISA management’s representations and exercised professional skepticism. Further, we assessed risk and performed a risk-based and standards-based audit approach in accordance with AU§318, AU§326, and AU§339. Acuity independently reviewed and observed DISA reconciliations and other procedures.

To address the DoDIG’s questions and clarify points apparently misunderstood, we prepared supplemental summary workpapers subsequent to the audit to more clearly document the work performed and tie related work together to facilitate a review by an independent reviewer. On August 30, 2012, we provided these workpapers to the DoDIG. We respectfully request that the DoDIG consider these supplemental workpapers in its present review and update the draft report to reflect consideration of these documents Acuity provided to further clarify our audit approach for the DoDIG.

WP References: 2400.50; 2500.03a.1; 4000E.95; 4000E.97; 5000F.15A.1; 5000F.15A.2

ECD: N/A.

Auditing Procedures of the General Property, Plant, and Equipment Line Item Could be Improved

DoDIG Report: Acuity did not perform procedures to determine whether the PP&E line item in the DISA FY2011 WCF Financial Statements was free of material misstatements.

Acuity Response: Acuity performed a risk-based and standards-based audit approach in accordance with AU§318, AU§326, and AU§339, as is more fully explained in the following subsections.

ECD: N/A.

Completeness Testing of Property, Plant, and Equipment

DoDIG Report: Acuity did not perform adequate testing of the TSEAS Network PP&E to verify the DISA compliance with the completeness assertion.

Acuity Response: AU§230, *Due Professional Care in the Performance of Work*, requires the auditor to plan and perform the audit to “obtain sufficient appropriate audit evidence so that audit risk [is] limited to a low level that is, [based on the auditor’s professional judgment] appropriate for expressing an opinion on the financial statements.” (AU§230.10) Further, as noted in AU §230.11, the auditor uses professional judgment “regarding the areas to be tested and the nature,

timing and extent of the tests to be performed.” Acuity assessed risk and performed risk-based and standards-based procedures on all components of TSEAS PP&E. Specifically, Acuity:

- Documented our inability to rely on DPAS for certain classes of TSEAS PP&E and noted that we would apply alternative procedures for testing completeness with respect to TSEAS network PP&E. The nature of network assets and lack of a reliable subsidiary ledger impaired our ability to perform routine audit procedures such as floor-to-book testing or comparison of DPAS records to accounts payable transactions. Accordingly, we designed alternative procedures to test completeness with respect to TSEAS network PP&E.
- Determined appropriate alternative procedures. Having documented that this area of TSEAS PP&E relied upon a pending assets process in conjunction with an authorized capital budget, we determined an appropriate alternate procedure for testing the completeness assertion consisted of evaluating the effectiveness of controls over the budget process; reviewing the pending assets reconciliation process; testing, on a sample basis, the values recorded in the pending assets accounts; and assessing the related internal controls. The results of these tests supported our assessment that the risk of material misstatement was low with respect to completeness of this component of TSEAS PP&E.
- Tested the TSEAS pending assets process (including certain transactions to test controls) as well as the capital budget process. Our tests included obtaining and reviewing supporting documentation. The DoDIG refers to notations in our workpapers regarding the lack of a certain type of document (SF 1080) to support certain transactions. In those instances, we relied upon other readily available documentation (*to wit*, “CHOOSE reports”) as an acceptable alternative to the SF 1080 (and used in many other tests of similar transactions). We have clarified this in our workpapers.

As noted above and in accordance with the auditing standards, our analysis as a whole and the procedures we performed with respect to completeness reduced risk to an acceptable level, which is documented in our workpapers.

To address the DoDIG’s questions and clarify points apparently misunderstood, we prepared supplemental summary workpapers subsequent to the audit to provide clarity with respect to our conclusions and to more fully reference and link the work performed throughout the audit to facilitate a review by an independent reviewer. The supplemental summary workpapers have been updated to further clarify the extent of our procedures.

On August 30, 2012, we provided the supplemental summary workpapers with our fully documented conclusions to the DoDIG, but it does not appear this information was considered in the draft report. We respectfully request that the DoDIG consider these supplemental workpapers in its present review and update the draft report to reflect consideration of these documents. Acuity provided to further clarify our audit approach for the DoDIG.

WP References: 4000E.70; 4000E.95

ECD: N/A.

Acuity did not state that the DISA Financial Statement Footnote Disclosures were Inadequate in their Auditor's Report

DoDIG Report: Acuity did not state in its auditor's report that the DISA financial statement footnote disclosures were inadequate because they did not discuss DISA's Grouped Asset Cost Method and Grouped Asset Activation and Depreciation Method.

Acuity Response: The financial statements accompanied by the auditor's report for FY 2011 could have included more complete disclosures for PP&E. But AU§561.06.a. allows for revision of only the most recently issued financial report, while AU§561.06.b. states that "when issuance of financial statements accompanied by the auditor's report for a subsequent period is imminent ... appropriate disclosure of the revision can be made ... instead of reissuing the earlier statements." Acuity ensured that DISA made the appropriate corrections and revisions to the note disclosures to the FY 2012 comparative financial statements and we included an explanatory paragraph in the audit report, which was issued November 15, 2012.

Further, as of August 30, 2012, when Acuity discussed these concerns with the DoDIG, no need existed to reissue the FY 2011 audited financial report. Specifically, in accordance with AU§561.06.b., the issuance of the audited financial report for FY 2012 was imminent. OMB Bulletin No. 07-04 (as amended by M-09-33), *Audit Requirements for Federal Financial Statements*, paragraph 5.6 states that "imminent means within 90 days of determining the effect of the misstatement(s) on the previously issued financial statements." As stated in the previous paragraph, the final FY 2012 audited financial report was issued November 15, 2012, which was within 90 days. Accordingly, reissuance of the FY 2011 audited financial report is neither necessary nor appropriate.

WP References: 4000E.97

ECD: Completed November 15, 2012.

DISA did not disclose Grouped Asset Cost Method

DoDIG Report: During the review of the FY 2011 beginning balances, Acuity issued an NOF discussing the DISA grouped asset cost method. Acuity stated that the NOF was caused from DISA using a grouped asset costs approach rather than the individual cost approach to identify and value assets. Acuity determined that the effect of the grouped asset cost method increased the likelihood that a material misstatement would not be prevented or detected.

Acuity Response: The financial statements accompanied by the auditor's report for FY 2011 could have included more complete disclosures for PP&E. But AU§561.06.a. allows for revision of only the most recently issued financial report, while AU§561.06.b. states that "when issuance of financial statements accompanied by the auditor's report for a subsequent period is imminent ... appropriate disclosure of the revision can be made ... instead of reissuing the earlier statements." Acuity ensured that DISA made the appropriate corrections and revisions to the note disclosures to the FY 2012 comparative financial statements and we included an

explanatory paragraph in the audit report, which was issued November 15, 2012. Accordingly, reissuance of the FY 2011 audited financial report is neither necessary nor appropriate.

DoDIG's many references to DoD 7000.14-R, also known as the DoD Financial Management Regulation (DoD FMR), are not relevant as a standard in discussing the financial statement audit conducted by Acuity. The DoD FMR is a DoD policy and is neither part of the U.S. GAAP hierarchy nor professional auditing standards (e.g., AICPA Statements on Auditing Standards; GAO-12-331G, Government Auditing Standards) that an IPA firm is required to follow in performing a financial statement audit of a government entity.

WP References: 4000E.97

ECD: Completed November 15, 2012.

DISA did not disclose Grouped Asset Activation and Depreciation Method in its Financial Statements

DoDIG Report: The DISA grouped asset activation and depreciation method deviated from the standards in the DoD FMR. DISA did not disclose any of the issues with the grouped asset cost activation and depreciation method in its financial statements.

Acuity Response: DoDIG's many references to DoD 7000.14-R, also known as the DoD Financial Management Regulation (DoD FMR), are not relevant as a standard in discussing the financial statement audit conducted by Acuity. The DoD FMR is neither part of the U.S. GAAP hierarchy nor professional auditing standards (e.g., AICPA Statements on Auditing Standards; GAO-12-331G, Government Auditing Standards) that an IPA firm is required to follow in performing a financial statement audit of a government entity.

The financial statements accompanied by the auditor's report for FY 2011 could have included more complete disclosures for PP&E. But AU§561.06.a. allows for revision of only the most recently issued financial report, while AU§561.06.b. states that "when issuance of financial statements accompanied by the auditor's report for a subsequent period is imminent ... appropriate disclosure of the revision can be made ... instead of reissuing the earlier statements." Acuity ensured that DISA made the appropriate corrections and revisions to the note disclosures to the FY 2012 comparative financial statements and we included an explanatory paragraph in the audit report, which was issued November 15, 2012. Accordingly, reissuance of the FY 2011 audited financial report is neither necessary nor appropriate.

Additionally, we noted an inaccurate statement in the draft report with respect to one component of TSEAS PP&E. Specifically, the DoDIG indicates that "DISA starts asset depreciation in September of the year the grouped asset is activated." In fact, in FY 2011, DISA used June as the activation month. This is clearly stated in our workpapers.

WP References: 4000E.97

ECD: Completed November 15, 2012.

Acuity's Audit Report Did Not State that the DISA Informative Disclosures Were Inadequate

DoDIG Report: Acuity did not comply with GAGAS because they did not state in the auditor's report that the DISA informative disclosures were inadequate. The DISA grouped asset cost method and the activation and depreciation method are not in accordance with accounting policy for Property, Plant and Equipment in the DoD FMR.

Acuity Response: Acuity assessed risk and performed risk-based and standards-based procedures on PP&E in conducting the audit. We appropriately documented our understanding and our work followed appropriate standards, including GAGAS, GAO/PCIE FAM, and AICPA standards.

DoDIG's many references to DoD 7000.14-R, also known as the DoD Financial Management Regulation (DoD FMR), are not relevant as a standard in discussing the financial statement audit conducted by Acuity. The DoD FMR is a DoD policy and is neither part of the U.S. GAAP hierarchy nor professional auditing standards (e.g., AICPA Statements on Auditing Standards; GAO-12-331G, Government Auditing Standards) that an IPA firm is required to follow in performing a financial statement audit of a government entity.

The financial statements accompanied by the auditor's report for FY 2011 could have included more complete disclosures for PP&E. But AU§561.06.a. allows for revision of only the most recently issued financial report, while AU§561.06.b. states that "when issuance of financial statements accompanied by the auditor's report for a subsequent period is imminent ... appropriate disclosure of the revision can be made ... instead of reissuing the earlier statements." Acuity ensured that DISA made the appropriate corrections and revisions to the note disclosures to the FY 2012 comparative financial statements and we included an explanatory paragraph in the audit report, which was issued November 15, 2012.

Further, as of August 30, 2012, when Acuity discussed these concerns with the DoDIG, no need existed to reissue the FY 2011 audited financial report. Specifically, in accordance with AU§561.06.b., the issuance of the audited financial report for FY 2012 was imminent. OMB Bulletin No. 07-04 (as amended by M-09-33), *Audit Requirements for Federal Financial Statements*, paragraph 5.6 states that "imminent means within 90 days of determining the effect of the misstatement(s) on the previously issued financial statements." As stated in the previous paragraph, the final FY 2012 audited financial report was issued November 15, 2012, which was within 90 days. Accordingly, reissuance of the FY 2011 audited financial report is neither necessary nor appropriate.

Furthermore, the DoDIG states "Acuity expressed concerns about the depreciation methodology to DISA" in FY 2012, and DISA made inquiries to the FASAB regarding the issue. In FY 2012, DISA did change the group activation date to September (rather than June in FY 2011), and Acuity expressed concerns about this change. The DoDIG also states the matter regarding group activation is unresolved. In fact, based on Acuity's concerns about using September, DISA continued using the June date as of 9/30/2012 and declined to pursue the issue with FASAB.

Acuity respectfully disagrees that the work was inadequate.

ECD: N/A.

The Contracting Officer's Representative Was Unable to Complete Key Duties to Provide Oversight

DoDIG Report: ...the COR provided comments on documents received in the planning phase, including the Plan of Actions & Milestones [POAM]. In addition, the COR expressed concerns that Acuity failed to provide a detailed audit plan. The COR stated that Acuity did not provide a complete audit plan until February 2010, four months after the beginning of the audit.

Acuity Response: While this finding is directed to the DISA DoDIG, Acuity believes the OIG report is inaccurate based upon the following reasons:

- The COR reviewed very little of the work performed and provided essentially no feedback beyond the POAM. While the POAM represented a contractual requirement, it was not representative of true audit planning documentation.
- While noting the COR reviewed the POAM, the report does not mention that the POAM was delivered in advance of the contractual requirement on 11/26/2010 and we duly responded to the COR's comments and questions on 12/6/2010. The audit plan was not a contract deliverable, but was provided to the COR within two months of the request (the fact this was "four months after the beginning of the audit" is irrelevant [see OIG Report, page 15]).
- The timing and delivery of the audit plan was consistent with the timeline presented in the draft report and was representative of typical audit planning for a first-year audit of a client of this complexity and size.

ECD: N/A.

Audit Standards Require Reissuance of Auditor's Report

DoDIG Report: AU Section 390, Consideration of Omitted Procedures, states that if an auditor concludes an omission of auditing procedures considered necessary at the time of the audit impairs his present ability to support a previously expressed opinion, he should promptly apply the omitted procedure or alternative procedures that would provide a satisfactory basis for his opinion. ...AU Section 561, Subsequent Discovery of Facts, Chapter .05 states, in part, that when the subsequently discovered information is found to be both reliable, existed, and material to the financial statements at the date of the auditor's report, the auditor should take action to prevent further reliance on the report.

Acuity Response: The DoDIG's application of AU§561, *Subsequent Discovery of Facts*, is incorrect. The correct standard to apply first is AU§390, *Consideration of Omitted Procedures After the Report Date*. After review of AU §390, we concluded there was no impairment to our ability to support and provide a satisfactory basis for our previously expressed *opinion*, but the issue regarding complete note disclosures for FBWT and PP&E could have affected the FY 2011 report. Acuity applied the omitted procedures subsequent to the audit report date in accordance

with AU§390. On August 30, 2012, this information was provided to the DoDIG, but evidently was not considered in developing their draft report. AU§390.06 states the auditor should be guided by the provisions of AU§561.05–09. AU§561.06.a. states “...only the most recently issued audited financial statements would need to be revised...” AU§561.06.b. provides further guidance: “when issuance of financial statements accompanied by the auditor’s report for a subsequent period is imminent, so that disclosure is not delayed, appropriate disclosure of the revision can be made in such statements instead of reissuing the earlier statements pursuant to subparagraph (a).” Acuity ensured that DISA made the appropriate corrections and revisions to the note disclosures to the FY 2012 comparative financial statements and we included an explanatory paragraph in the audit report, which was issued November 15, 2012.

Further, as of August 30, 2012, when Acuity discussed these concerns with the DoDIG, no need existed to reissue the FY 2011 audited financial report. Specifically, in accordance with AU§561.06.b., the issuance of the audited financial report for FY 2012 was imminent. OMB Bulletin No. 07-04 (as amended by M-09-33), *Audit Requirements for Federal Financial Statements*, paragraph 5.6 states that “imminent means within 90 days of determining the effect of the misstatement(s) on the previously issued financial statements.” As stated in the previous paragraph, the final FY 2012 audited financial report was issued November 15, 2012, which was within 90 days. Accordingly, reissuance of the FY 2011 audited financial report is neither necessary nor appropriate.

Acuity respectfully disagrees the audit report requires reissuance.

WP References: 2500.03a.1

ECD: N/A.

DISA Contract Required Acuity Compliance with Government Auditing Standards

DoDIG Report: The DISA audit contract required that Acuity comply with standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States. Because Acuity did not have sufficient evidence to issue an unqualified opinion on the FY 2011 DISA WCF Financial Statements, their work did not comply with Government Auditing Standards.

Acuity Response: Acuity designed a risk-based audit approach in accordance with audit standards, including AU§318, *Performing Audit Procedures in Response to Assessed Risk*; AU§326, *Audit Evidence*; AU§339, *Audit Documentation*; and AU§508, *Reports on Audited Financial Statements*. We obtained sufficient and appropriate audit evidence to support our conclusions and provide a reasonable basis for our opinion. Our professional judgment as to what constituted sufficient appropriate audit evidence was influenced by factors such as the significance of the potential misstatement in the relevant assertion and the likelihood of its having a material effect, individually or aggregated with other potential misstatements, on the financial statements. Additionally, we considered: the effectiveness of management’s responses and controls to address the risks; the experience we gained during previous audits; our understanding of DISA and its environment, including its internal controls; the source and

reliability of available information; and the persuasiveness of the audit evidence. We appropriately documented our understanding and our work followed appropriate standards, including GAGAS, GAO/PCIE FAM, and AICPA standards. Therefore, Acuity respectfully disagrees that Acuity did not comply with Government Auditing Standards.

WP References:

- Audit Plan: 1200.05; 1200.52; 1200.53
- Quality Control Checklists with AICPA and FAM References: 1400.01; 1400.02; 1400.03; 1400.04; 1400.05

ECD: N/A.

Respectfully,



Alan B. Spencer
Managing Partner
Acuity Consulting, Inc.

Date: 2/8/13



Inspector General Department *of* Defense